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Supreme Court of the United States

OCTOBER TERM, 1928.

No. 131.

THE ST. LOUIS AND O'FALLON RAILWAY COMPANY and MANUFACTURERS' RAILWAY COMPANY,

Appellants,

vs.

UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION,

Appellees.

No. 132.

UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION,

Appellants,

vs.

THE ST. LOUIS AND O'FALLON RAILWAY COMPANY and MANUFACTURERS' RAILWAY COMPANY,

Appellees.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI.

REPLY BRIEF OF APPELLANT RAILWAY COMPANIES.

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UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION, *Appellants*, vs. THE ST. LOUIS AND O'FALLON RAILWAY COMPANY and MANUFACTURERS' RAILWAY COMPANY, *Appellees.*	No. 132

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI.

REPLY BRIEF OF APPELLANT RAILWAY COMPANIES.

VALUE AND KINDRED ISSUES.

The brief of the United States does not challenge the soundness of the rule of *Smyth* v. *Ames* that value is not a matter of formula but a thing to be determined by the consideration of all relevant circumstances. It undertakes to support the value found by the Commission on the theory that the courts cannot interfere with the discretion of the Commission in determining value.

The brief of the National Conference on Valuation of American Railroads challenges the soundness of the *Smyth* v. *Ames* rule in an elaborate argument based primarily upon the contention that public utility property is not private property and as such protected by the Fifth and Fourteenth Amendments, but that the legislative department of the Government and administrative tribunals created thereby may, without judicial restraint, except in cases of clear abuse, establish rates based upon their conceptions of economic and administrative expediency. The right of the utilities to the protection of the Fifth Amendment being denied, the sources of judicial power of review suggested, its scope and the circumstances under which it may be exercised, are not clearly defined. In practical effect the contentions urged would make the action of legislative or administrative bodies supreme. The advocacy of the prudent investment theory as a test which should now govern appears to rest on no judicial, constitutional or statutory authority, and on no theory of law, but solely upon considerations of economic and administrative expediency satisfactory to the writer. Under the arguments advanced in its support, legislative or administrative authority would be equally free in a

period of low prices, and from the same considerations of economic and administrative expediency, to substitute reproduction cost at prices then current for the prudent investment. The necessary conclusion to be drawn from this brief is that the determination of value is a question solely for the legislative or administrative branches of the Government, subject to no judicial review or constitutional restraint. This Court has repeatedly held that it will not review the expediency or wisdom of an order or finding of a Commission in respect of questions within its administrative or legislative jurisdiction. By making the determination of value depend upon such considerations of expediency this brief, although preserving the appearance of judicial review, is based upon theories wholly inconsistent with its existence.

The brief of the Commission recognizes that, under the decisions of this Court, the rule of *Smyth* v. *Ames* is still the law and, like the brief of the Government, undertakes to support the Commission's valuation as one which meets the test of that case. It interprets *Smyth* v. *Ames*, however, not as requiring the finding of the actual value, or economic equivalent, of the property, but as requiring a determination of a rate base, which is said to be impossible of definition, and which is so loosely described that any determination may be justified as conforming to its vague standard. The major portion of its discussion of value is devoted to an effort to overturn as much of the rule of *Smyth* v. *Ames* as requires that any consideration be given to present as compared with original cost of construction, in the determination of present value, and to an advocacy of original cost or prudent investment as the primary basis of public utility valuation,—although it stoutly

denies that the Commission based its valuation on that theory. As in the brief of the National Conference, the arguments put forth are arguments of administrative and economic expediency, based in turn upon the assumption that the whole matter is one primarily addressed to the discretion of an administrative tribunal, subject to no judicial review or constitutional restraint.

Each of the briefs filed is remarkable for its complete lack of any review of the relevant facts bearing upon the valuation of the property of this railroad. Each proceeds as though this were a rate case, brought by all the railroads of the United States, for the purpose of requiring the Interstate Commerce Commission to permit such advances in rates as would yield a fair return upon the value of all railroad property in the United States, determined upon the basis of the spot reproduction cost of all such properties at the time of the inquiry. Despite statements to the contrary in the briefs of the United States and of the Commission, each of these briefs proceeds upon the theory that value *is* a matter of mathematical formula, that if effective weight be given to current prices in the determination of the value of this property, similar weight must be given in determining the value of *all* railroad property, and that all rates *must* be advanced to yield a fair return upon aggregate value so determined. This is not, of course, the law either as to valuation or rate-making.

Nor is it a proper view of the issues of this case. The O'Fallon's income was earned under rates which according to all three briefs are reasonably low and the continuance of which is recognized to be necessary to support the credit of the carriers as a whole and to the successful administra-

tion of the Transportation Act. The only question involved is how much, if any, of the income derived under these rates is subject to recapture. This in turn involves only a consideration of the facts and circumstances bearing upon the value of this particular carrier. It does not require a valuation of all the railroads of the United States or the development of a formula according to which, on the grounds of economic and social expediency, all of the railroads might be valued.

1. Notwithstanding the efforts of the Commission's Brief to establish the contrary, the Commission did not determine the actual present value of the property of the O'Fallon, but attempted to ascertain the approximate investment in the property.

It is said (Commission's Brief, pp. 41-49) that the Commission's valuation was not based on the prudent investment theory, but was a determination of value in accordance with the rule of *Smyth* v. *Ames*. It requires but a cursory reading of the Report to establish the contrary. Close analysis confirms this conclusion. The method pursued and the express purpose of its use, as disclosed by the Report (Carriers' Opening Brief IV, pp. 52-59), and a comparison of the value found with the evidence before the Commission (Opening Brief IV, *supra*, V, pp. 60-75), establish beyond question that the Commission did not determine or undertake to determine the actual value of the carrier's property but attempted to approximate the investment therein.

Other parts of the Report, including those cited by counsel, support this conclusion. The Commission itself (R., 71) divides its "valuation problem into two parts," to

wit, a determination of the value of the "older property" as to which "it is without reliable information as to original costs" and of the newer property, as to which "costs • • • can be verified and checked." All such newer property, added since December 31, 1919, it included in its valuation at actual cost (R., 76 77). All such newer property, added between June 30, 1914 and June 30, 1919, was also included at its original cost by adding the amount by which such cost exceeded its cost of reproduction at 1914 prices (R., 74). In respect of the older property, to wit, structures antedating June 30, 1914, it made "resort • • • to the application to complete inventories" of 1914 prices as a substitute for original cost. This was because "in those cases, of which there are many, and of which the present case is an example, where it is impossible to ascertain and analyze the actual investment," resort to such method must be had (R., 75), a method which it is said affords a reliable means "for use in approximating the probable, reasonable and necessary costs of constructing railroads built prior to June 30, 1914" (R., 76).

On page 36 of the Report (R., 70) the Commission likens the structures of a railroad system to a great river like the Mississippi, "composed of waters from myriads of different systems," just as "a railroad system is a composite of materials acquired at myriads of different prices and at infinitely varying different periods of time and put into the plant at many different levels of wages." As a result it is said (R., 70), that "the only thing that does and can represent what the investor has contributed to the value of the property is the aggregate amount which was paid for the many different items in the perpetual stream of metamorphosing railroad struc-

tures." On page 38 of the Report (R., 72), after having stated (R., 71) that in respect of railroads generally there is a lack of definite and dependable cost records prior to 1907, it advocates the adoption, in determining the value of all railroad property, of a method by which actual cost of additions and betterments should be added to valuations under Section 19a. These 19a valuations, as stated in the Report, have been based on the application of 1914 prices to property in existence in 1914, on the ground that (R., 74-75), resort must be had to 1914 prices,—wherever, as in this case, cost records are lacking,—as a substitute for original cost and a reliable approximation thereof.

Such a method of determining the value of all railroad property, it is said (R., 72), would be "simple and easy of application," would involve "no great expense or delay," and would insure "a fair return • • • for every dollar that has gone into the project." The Commission expressly refused to give any weight whatsoever to the present price level except as reflected in the investment in units actually installed at such prices (R., 73). The Report endeavors to explain away prior decisions of this Court in which it has been held that weight must be accorded to present, as compared with original, cost of construction, upon the theory that cost of reproduction estimates were resorted to in those cases as a substitute for an unascertainable original cost (R., 73). But it plainly appears from those decisions that such estimates were not resorted to for that purpose, but because it is the present value and not the original cost, whether higher or lower, which must be determined. Having thus undertaken to distinguish this case from decisions of this Court rendered

prior to the War, the Report significantly omits any reference to or discussion of *Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U. S. 276, and *McCardle* v. *Indianapolis Water Co.*, 272 U. S. 400. In each of these cases the present value rule was restated, and effective weight given to the present price level, at a time when reproduction cost estimates could not conceivably have been resorted to as a substitute for unascertainable original cost. Finally, the Commission asserts that "it may well be that the valuation of railroads on a national scale requires the beginning of a new chapter in valuation" (R., 61). Other references to the superiority of the prudent investment theory over the present value theory will be found running through the Report.

From the Report as a whole, therefore, as well as from an analysis of the method which the Report discloses, it plainly appears that the Commission did not undertake to determine the actual value of the property of the O'Fallon by a consideration of all relevant facts and circumstances, but that it deliberately challenged the soundness of the present value rule and based its valuation on the prudent investment theory (except in respect of lands), because in its judgment the value of all railroad property should be so ascertained and determined. Such is the minority's understanding of the Report and, it is believed, will be the inevitable conclusion of this Court. Counsel in seeking to maintain the Commission's valuation upon the theory that it was a valuation made under the rule of *Smyth* v. *Ames*, are thus less frank than the Commission has been and are, it is submitted, endeavoring to sustain the order of the Commission upon a theory at complete variance with the Report itself.

As evidence that the Commission did not adopt the prudent investment theory, counsel refer to the fact that the carriers' lands were included at their present value. This appears on the face of the Report and was so stated in the carrier's opening brief. If it had pursued the same course in respect of the carrier's other property, its valuation would not be in dispute. The value placed upon the carrier's lands, $50,500, is a comparatively negligible part of the whole valuation, which ranged from $850,500 in 1919 to a little less than a million dollars in 1923. Nor did the substitution of present value for original cost have any material effect upon the result, since the original cost was reported by the Commission's accounting section to be $37,000 (R., 508-9), but $13,000 less than the value found.

It is plain that the Commission valued the O'Fallon according to the formula above referred to,—cost of reproduction, less depreciation, at 1914 prices, plus the adjustment necessary to include, at their original cost, additions and betterments made since 1914. It fixed the value of the property, other than lands and working capital, as of June 30, 1919, at $750,000 (R., 65). Cost of reproduction, less depreciation, of the structural elements of such property as of that date, at 1914 prices, was $678,506 (R., 74). To this the sum of $38,843.12 was added to bring the value of units installed between July 1, 1913, and June 30, 1919, up to their original cost (R., 74). It is true that the value of $750,000 is $32,660.88 in excess of the sum of the cost of reproduction, less depreciation, at 1914 prices, and the amount added to bring the value of units installed between June 1, 1914, to July 30, 1919, up to their original cost. In our opening

brief we said that this addition was apparently intended to cover appreciation, going concern value and other intangible elements of value in harmony with the Commission's usual practice to add about five per cent. for such purposes.

The Government and the Commission make much of the addition of this sum, and use it as the basis for much of their argument that the Commission did not proceed upon the investment theory. They deny that it was added to cover these elements of value; but they do not enlighten us as to its purpose, if something else. The Commission disclaimed any intention of employing any "intermediate process" by which it would give less than full effect to present reproduction costs (R., 73, quoted p. 62, our opening brief). That the sum added was totally inadequate to reflect enhanced costs of construction is, of course, clear.

Some allowance for going concern value, appreciation and other intangible elements of value, if any, is not inconsistent even with the original cost basis. It is well known that the creation of these elements of value, after the close of the construction period (to which the Commission's overheads referred to in the Commission's brief alone relate) frequently costs money which, although absorbed in operating expenses, reduces the carrier's rate of return during the early periods of its operation below a normal or fair rate of return. Extraordinary maintenance expenses are encountered, friendly relations with shippers and connections must be established, and other extraordinary expenses incident to the launching of the enterprise incurred. Even on an original

cost basis such an allowance would therefore appear to be appropriate, and in fixing a single sum basic valuation as of June 30, 1919, the Commission, after reciting the figures representative of cost of reproduction of the older property at 1914 prices, refers to the costs of appreciation and to the carrier as being one "in successful operation and with an established business" (R., 74). Contrary to statements of counsel, the context would thus appear to support the suggestion that, in harmony with its course in the making of valuations under Section 19a, the Commission made this allowance, approximating five per cent., to cover these elements of value and their probable cost.

However this may be, the fact remains that the primary basis of the Commission's determination of the value of the structural elements of the property in existence on June 30, 1914, which constitutes the major portion of its property, was its cost of reproduction less depreciation at 1914 prices. It also appears on the face of the Report that this method of determining the primary basis for the valuation of this older property was resorted to upon an assumption that it would approximate original cost, reliable information as to original cost being lacking, although, as shown in our opening brief, this assumption was without any support in the evidence.

Reliance is also placed on the fact that the Commission in its Report says that it gave due consideration to all elements of value. We do not accept the Commission's proposed solution (Brief, pp. 51-2):

> "All these difficulties disappear if the Commission's own statements, above quoted, are accepted as correct statements of its use of 'judgment' and not of 'formula.'"

The Commission is to be judged by what it did, not by what it said. It is to be judged by the Report as a whole, not by a single detached sentence.

Counsel for the Commission cite *Utilities Commission v. Springfield Gas and Electric Co.*, 291 Ill. 209, in support of certain propositions urged by them in justification of the Commission's valuation. That case contains an elaborate discussion of various matters to be taken into consideration in the determination of value. It is significant, however, that despite the supposed support which counsel obtains from it, the case held that the order at issue must be set aside because the Commission had failed to determine the present value of the property but had based its finding of value upon an ascertainment of original cost. This notwithstanding the fact that the Report of the Commission in that case, as in this case, declared that it had given due consideration to *all* elements of value. The court says:

> "• • • • The commission declares in its opinion in this case that the valuation fixed was determined by considering, among other elements, the original cost and the cost to reproduce. A fair consideration of the record shows that no element was considered, except the original cost of construction, less depreciation. In this the commission was in error. A fair present value of a public utility cannot be determined without full and proper consideration being given to the cost to reproduce new. As was said by the Supreme Court of the United States in *Lincoln Gas & Electric Light Co. v. City of Lincoln*, 250 U. S. 256:
>
> "'It is a matter of common knowledge that, owing principally to the World War, the costs

> of labor and supplies of every kind have greatly advanced since the ordinance was adopted, and largely since this cause was last heard in the court below; and it is equally well known that annual returns upon capital and enterprise the world over have materially increased, so that what would have been a proper rate of return for capital invested in gas plants and similar public utilities a few years ago furnishes no safe criterion for the present or for the future'
>
> "The commission must, in its final decision in all such cases, determine (1) the present value of the property for rate-making purposes; (2) the rate of return to which the utility is entitled; and (3) the fair and reasonable rate to be charged for the service. For this error and other errors hereinbefore pointed out, this cause must be remanded to the commission, and the commission will on further consideration make *specific* and *separate* findings of its ultimate conclusions as to each element of value considered."

It is significant that this case was decided before the decision of this Court in *Southwestern Bell Telephone Co.* v. *Public Service Commission*, *supra*. A similar case is *Monroe Gas Light & Fuel Company* v. *Michigan Public Utilities Commission*, 292 Fed. 39, in which the Court said:

> "It is plain from its exhaustive report that the Michigan Commission in this case followed practically in the lines of Mr. Justice Brandeis' dissenting opinion in the Southwestern Bell Case; and it will, of course, be noted that the action of the Commission was taken some time before this opinion was announced. The report of the Michigan Commission is most painstaking and thorough,

and displays obvious intent to deal fairly with the Utility—according to the Commission's view of the legal questions involved—in a degree which unfortunately has been absent in some cases in which judicial review of Commission conclusions in other states has been sought. It will be noted, however, that, pursuant to a common practice, the report seeks to immunize itself against attack by a careful declaration that no one element is given controlling effect in fixing the rate base, but that actual cost, investment, capitalization, reconstruction cost, depreciation, etc., are given, and each is given, due weight in reaching the final composite conclusion. As Mr. Justice Brandeis points out, such a report, like the general verdict of a jury, suggests immunity to any attack which depends upon showing that the Commission gave excessive or insufficient force to any one element. We do not see that an otherwise appropriate judicial revision can be escaped in this manner. It is the duty of the court to determine the rate base from the evidence before it; and while there must be great hesitancy in overturning a conclusion reached by the Commission, after it has considered all relevant facts, neither presumption nor express statement by the Commission that it has given due weight to every one can prevail against a contrary inference required by the proofs" (pp. 143-144).

2. The contention that the Commission's refusal to give effective weight to current prices was due to the absence of competent evidence of cost of reproduction is without support in the record and contrary to the fact.

On pages 39-40 of the Commission's brief, it is said that the Commission gave due consideration to current

cost of reproduction. On pages 43 *et seq.* of the brief it is argued that there was no competent evidence of cost of reproduction, and that the Commission's refusal to give effective weight to current prices was due to this fact. Both of these contentions cannot be true. In fact, neither is. The only consideration which the Commission gave to current reproduction cost was to reject it as an irrelevant fact entitled to no consideration whatsoever (R., 73). This it did solely because the property cost less, and because it was of the opinion that prudent investment rather than present cost of construction should be made the primary basis of valuation in this and all other public utility cases.

If, however, it be true that there was no competent evidence of reproduction cost, then the order is void on this account alone. (See *Southwestern Bell Tel. Co.* v. *Public Service Commission*, *supra*, in which the order of the Commission was set aside because of the absence of such evidence.) The proceeding was not one in which, as in one instituted by the carrier to obtain a rate increase, the burden is on the carrier to establish the value of its property. It was a proceeding initiated by the Commission for the purpose of taking away from the carrier a part of that which it claimed as its property, to it, its income. The Commission's statutory power to appropriate any part of such income for the use of the United States, or to require any part of it to be placed in a reserve fund, was dependent upon an adequate and proper determination of the value of the property. It offered the carrier an opportunity to be heard; but the validity of its order must depend upon the sufficiency of the evidence upon which it is based.

But it is not a fact that there was no competent evidence of cost of reproduction, or that there was a dearth of reliable data from which it could be ascertained. This evidence was supplied by the Commission itself, through one of its qualified valuation engineers, whose testimony is reviewed in our opening brief (pp. 72 to 75). The statement from the report on page 46 of the Commission's brief,—that the only evidence in respect of the cost of reproduction of the O'Fallon "is that of the relation of general prices in 1914 and in 1920 and the other recapture years",—is a clear misinterpretation of the evidence before the Commission. The index numbers testified to by the Commission's engineer and witness were not those reported by the Bureau of Labor or any other institution to show the relation of general prices in these periods. As shown by his evidence, referred to and quoted from in our opening brief, they were based upon a consideration of prices paid for materials and labor entering into railroad construction, and represented a composite index number for application to the carrier's structures as a whole. The source from which taken were stated by him to be in his opinion authentic and reliable, and in so far as disclosed by his testimony are of such character. He expressed the opinion that, when applied to 1914, they would be fairly representative of reproduction cost in the recapture years. His opinion testimony offered by the Commission was in effect accepted by the railroad company without question.

It is also said (Commission's brief, p. 45) that the extent to which these increased prices might be overcome by improved methods of assembly and construction was not disclosed, "although the carriers were afforded every

opportunity to present evidence upon this as upon all other relevant matters"; and it is stated that the Commission found in the Texas Midland case that "the increase in the cost of labor and materials between 1900 and 1914 was largely offset by improvement in the art of construction." The evidence, if any, supporting such finding in that case, was not offered, nor was reference made to it by any witness for the Commission. Presumably its own witness took these factors into consideration, to the extent present, in the development of his index factors. His opinion testimony was offered by the Commission itself as that of a competent engineer capable of estimating construction costs. Reproduction estimates made by the company's engineers were also accepted as competent evidence, without any objection that they failed to take into account the offsetting influence of construction methods; nor was any witness cross examined along this line. The suggestion that it was the duty of the carrier in the cross examination of the Commission's witness to support and sustain his testimony, by showing that he had taken this and all other factors into account, is unsound.

It is also said, quoting from the Report (Commission's brief, p. 45), that there was very little new railroad construction during the recapture periods in question. This again is a statement based on no evidence of record. Nor does it appear how much more, if any, railroad construction took place in the Commission's own pricing period between 1910 and 1914. The Commission's 41st Annual Report (1927), p. 4, shows that 3,113 miles of railroads have been constructed between 1920 and 1927, and that the Commission has authorized the construction of 6,446 miles; and with each application for new construction it

requires and receives an estimate of its cost.[1] During the same period it has dismissed or denied application for the construction of over 5,000 miles.[2] The certificates of public convenience issued, together with those denied, likewise answer the suggestion that it would not have been prudent to build a railroad during this period at the prices then prevailing. Railroad corporations have thought it prudent to do so and the Commission has authorized such construction. That construction of the O'Fallon, during any of these periods, at its full cost of reproduction, would have constituted a prudent investment by reason of realizable earnings at current low rates (Opening Brief, pp. 68 to 70), is not denied.

As stated in the Report of the Commission, nearly $4,000,000,000 was added to the investment in railroad property between 1920 and the date of the Commission's report. The amount added between 1910 and 1914, the Commission's pricing period, was a little over $2,500,000,000 (42d Annual Report, 1928, Table V, p. 113). With appropriate allowance for difference in price levels, the amount of data available from records of capital expenditures is therefore about the same in the two periods. Furthermore, it is a well known fact that only a small part of the cost of railroad construction is subject to the influence of improved construction

[1] See Order of Division 4, January 22, 1924, "In the Matter of Applications under Paragraph (18) to (21), inclusive, Section 1, of the Interstate Commerce Act for Certificates of Public Convenience and Necessity for the Construction or Extension of Lines of Railroad."

[2] This total does not appear to have been compiled by the Commission. Figures for several years are given in the annual reports.

methods, or is dependent upon main line construction for the ascertainment of proper unit prices. Locomotives, cars, rails, ties, bridge material, lumber for buildings, are being constantly bought by railroad companies, for maintenance and repair work, in enormous quantities, and at prices readily ascertained. Labor involved in their placement, either on construction or maintenance work, is labor of the character employed daily in such work on railroads in operation, and the wages paid are a matter of record.

More than one-half of the property of this railroad consists of equipment. In the year 1923 alone, the last of the recapture periods, 232,000 freight cars, including 97,674 coal cars, were bought by the American railroads (Statistics of Railways, 1923, Statement 14). Large numbers of locomotives and cars were acquired during each of the preceding years (*ibid.*, Statement 15). In the same year 1,729,696 tons of new rails were laid, and 84,434,985 cross ties. Substantially similar amounts were laid in each of the preceding recapture years (*ibid.*, Statement 50a). In the year 1920, $38,048,037 was spent for new lines in construction, *i. e.*, for new lines and extensions (*ibid.*, 1920, Statement 48); in 1921, $18,884,834 (*ibid.*, 1921, Statement 48); in 1922, $59,466,185 (*ibid.*, 1922, Statement 48); and in 1923, $29,952,809 (*ibid.*, 1923, Statement 48).

This railroad is nine miles long. The estimated cost of reproduction at prices current is less than $2,000,000. It is idle for the Commission to suggest a dearth of reliable data from which its cost of reproduction at current prices could be ascertained, or to lead this Court to believe that, by reason of improved methods of construction,

it could be built for anything like its cost at pre-war prices. To do so is to ask the Court not only to disregard testimony offered by the Commission's own engineering witness, put on the stand as a competent witness for the purpose of supplying evidence as to cost of reproduction at current prices, but to close its eyes to facts of common knowledge.

3. The inconsistencies in the Commission's defense of its order disclose its artificiality.

The inconsistencies of the Commission's defense of its order serve to disclose the inherent artificiality of the Commission's determination. Torn between conflicting theories, the Commission is apparently at a loss to determine upon which to base its case.

1. The Commission's Report shows unmistakably that it intentionally adopted the prudent investment theory. Consequently, a great part of its brief is properly devoted to establishing that the prudent investment should be the basis of valuation. It is suggested that the true significance of the Transportation Act is not grasped unless it is realized that its purpose is to regulate the railroads on an investment basis (96 *et seq.*). The Commission is not embarrassed by the fact that this is in direct contradiction of the express language of the statute, which bases the regulation on value, determined in accordance with the law of the land. The brief even interprets the decisions of this Court pertaining to the Transportation Act as disclosing its intention to recognize investment and not value (97-98). It is urged that the Transportation

Act inaugurated a new legislative policy, which should result in a new judicial policy (100). The simplicity and economic desirability of regulation on a prudent investment basis is declared (114).

The Commission's brief then turns in the opposite direction. It emphatically denies that the Commission adopted the investment theory (41, 43-49). The brief asserts that *Smyth* v. *Ames* is still the law of the land, and argues at length that by no possibility can it be the law that any one element of value, such as reproduction cost, can be made the controlling criterion of value (39-40, 111-113). If not, original cost or prudent investment cannot be, and the order is invalid, according to the brief itself.

2. The Commission's brief roundly condemns the reproduction cost method. It is said to depend on the most unsatisfactory kind of evidence, mere expert opinion, which is exceedingly difficult to verify. It is criticised as fundamentally illogical, because the railroads are not reconstructed each year and cannot be (114-115). It is attacked as vague, uncertain and unscientific (116), and as purely fanciful since it involves imaginative processes (117). Difficulties involving the use of the reproduction cost of a substituted plant are suggested (123), and also difficulties arising in connection with property which was constructed at a charge to operating expense (125-126).

The Report of the Commission states that generally the original cost of a railroad is not known. In the absence of original cost figures, the Commission proposes to use for the railroads generally, and did use in this case, a pre-war reproduction appraisal. Yet the Commission's brief seeks to establish that reproduction cost

findings are fundamentally unsound. Its finding is not, and cannot be defended as a finding of actual investment, for there is no support in the record. If the estimated reproduction costs which are in the record are as fantastic and unsubstantial as the Commission states, it cannot be that they are any measure of the original cost, because they do not reflect the *actual* expense. Nor should they be used for any purpose. In these circumstances the finding of the Commission rests in mere caprice.

The brief denies the use of the reproduction costs as a means of approximating the prudent investment. That the Commission did not determine the actual present value of the property by a consideration of all relevant facts and circumstances, is clear. That it did base its valuation of the major portion of the carrier's property primarily upon an effort to ascertain its original cost, although without competent evidence in respect thereof, is equally clear. If, contrary to the Report, the use of 1914 prices in determining the value of the older property of the carrier was not for the purpose of arriving at the approximate investment therein, then the valuation found is clearly without support on any theory. If the prudent investment theory be sound and if there were proof, which there is not, that the approximate investment of the property in existence on June 30, 1914, could be determined by applying 1914 prices thereto, then the Commission's Order would rest on a rational basis. When the Commission in its brief repudiates resort to 1914 prices as a means of approximating the investment in the property, it cuts all rational ground from under the Commission's valuation. A reproduction estimate as of 1914 as such is wholly without relevancy. By the appli-

cation of proper index factors thereto, it may form the basis for a reproduction estimate at the time of the inquiry. If in reality representative of actual cost, it may be utilized as an estimate of such. But as a basis for the determination of the present value of property then in existence, it is in itself evidence of neither present value nor original cost nor of anything else.

4. The contention in our opening Brief that the Order is void even under the prudent investment theory, because unsupported by any evidence as to the actual or estimated cost of the major portion of the property, is not challenged by opposing counsel and is in itself fatal to the validity of the order.

In our opening brief (pp. 101-103), it was pointed out that the record contained no support for the assumption that the approximate investment could be determined by applying 1914 prices to property then in existence and (pp. 103 to 107) that the method pursued was arbitrary and artificial, and one by which the approximate investment in the property could not possibly be ascertained. Neither of these contentions is challenged by counsel for the United States, the Commission or the National Conference. Either is fatal to the valadity of the order.

5. The Commission's Brief, like its Report, deals with this case as if it were a general rate case—calling for a determination of the aggregate value of the railroads generally, and a determination of a proper rate of return as a basis for future rates—instead of a recapture case, calling for the determination of the excess income, if any, received by this carrier under existing rates.

The Commission's brief makes no reference to the particular facts and circumstances which pertain to the actual value of the O'Fallon. It states (p. 81) that value for rate making purposes is "an artificial judicial concept," and that all hope of its rational determination

> "must fade unless the final determination of the rate base or value for rate-making purposes is to rest upon the judgment of an expert Commission (protected by the court from abuse) as to what will constitute 'fair' treatment in a broad and just view of wise public policy as between a railroad investor (past and prospective) and the public" (p. 87).

It attempts to defend its valuation of the O'Fallon on the ground that the formula used would, if applied to all the railroads, produce an aggregate value upon which, at existing rates, the railroads either do, or will in the future, earn a return sufficient to attract new capital to the business. The brief states that "The procurement of new capital is indeed the crux of the whole railroad problem" (p. 103); that the Commission used substantially the same method of valuation in determining the value of all interstate railroads in 1920 (p. 67), on which the existing rates are based; that the credit of the carriers under such existing rates is now excellent and sufficient to attract new capital upon favorable terms (pp. 110-111), and that increased rates would be unfair to the public.

The Commission and its counsel have thus approached this case not as a recapture case, the purpose of which is to determine how much, if any, excess income, earned under existing rates, this carrier has in its possession, but as though it were a rate case involving the prescription

of rates for the future and in which all carriers in the United States were concerned.

When it determined the existing scale of rates, the Commission estimated the value of the railroads, and fixed the rates as nearly as possible at a point where, according to its estimate, a fair return for the carriers as a whole would be produced. These rates applied to all the carriers, regardless of whether any particular carrier received a fair return. Now, to determine the value in this particular case, the Commission has reversed the process. It has, in substance, determined what aggregate value for all the railroads would enable them to show what it thinks would be a fair return, under existing rates, and has adopted a formula of valuation which will produce that aggregate. Then it has applied the formula to the O'Fallon, without regard to the relevant facts and circumstances which determine the value of the O'Fallon and without regard to its specific right to certain income under Section 15-a.

6. Dealing with the case in this way, the Commission based its determination of value upon considerations which have no bearing upon value, but which pertain to the reasonableness of rates and the fairness of the carrier's return.

Under the Commission's method, the aggregate value of the railroads as a whole is not the sum of separately established values, each determined as a matter of fact by a consideration of all the relevant factors. On the contrary, aggregate value is first determined and fixed at such sum as may be necessary to sustain a desired rate

level, and when so fixed, is distributed among the several carriers on the basis of the formula evolved to obtain the result desired.

That such was the Commission's reasoning appears from the considerations stated by the Commission and its counsel to have been controlling in determining the value of this property. Upon any other theory, its entire discussion of the "national problem" with which it is confronted, of the importance of maintaining the credit of the carriers and yet of maintaining low rates, of the sufficiency of existing rates, and of the public hardship resulting from advances in rates, is without material bearing upon the case.

Obviously, Congress contemplated no such method of proach in the determination of the value of the property of any carrier. It directed that the value of each carrier should be determined by a consideration of all the facts and circumstances relevant thereto, and contemplated that aggregate value should be the sum of the separately established values of the several carriers. The considerations by which the Commission was governed arise only when, after such aggregate value has been ascertained, it becomes the duty of the Commission to fix the rate of return thereon, and the rates which will be fair and reasonable alike to the carriers and to the public. To determine the aggregate value first, upon the basis of a pre-determined rate result, involves the same vicious circle which is inherent in the determination of value through capitalization of earnings.

In the last analysis the considerations by which the Commission was governed and which are urged by counsel

in support of its valuation are therefore seen to rest upon the following assumptions:

(1) That the aggregate net operating income of all railways in the United States under the existing rates is adequate to insure the maintenance of the credit of the carriers at such a point as to attract on favorable terms the additional capital constantly required for the preservation and maintenance of an adequate system of national transportation.

(2) That any substantial increase in rates would be productive of public hardship and would result in unreasonable and unconscionable profit to the holders of railroad securities.

(3) That the formula followed by the Commission in determining the value of the property of the O'Fallon, if applied to all railroads in the United States, would result in the determination of an aggregate value of all railroad property which would support existing rates as affording a fair return, or prevent substantial rate increases.

(4) That although (1), (2) and (3) is each a conclusion of fact upon a matter which is open to controversy, and although each of these conclusions of fact is unsupported by any evidence whatsoever, they are all binding upon this Court, or, if not, should be accepted by it because the Commission is a body of great wisdom and experience.

7. The ability of the carriers as a whole to attract capital on any given set of rates has no bearing upon the determination of the value of either a particular railroad or on aggregate value, but is a consideration to be taken into account in fixing a fair rate of return on aggregate value when found.

(a) IN MAKING THE ABILITY OF THE CARRIERS AS A WHOLE TO OBTAIN NEW CAPITAL THE TEST OF VALUE, THE COMMISSION DISREGARDED THE EXPRESS PROVISIONS OF THE TRANSPORTATION ACT, WHICH DIRECTED THE COMMISSION TO GIVE CONSIDERATION THERETO IN FIXING THE RATE OF RETURN, BUT TO DETERMINE THE VALUE OF EACH PARTICULAR PROPERTY INDEPENDENTLY THEREOF AND IN ACCORDANCE WITH THE LAW OF THE LAND.

The Commission would make the ability of the carriers to obtain new capital on favorable and attractive terms the test of "fair value," and in support of this position, the Commission's Report (R., 72-73) and its brief (p. 42) refer to paragraph (3) of Section 15a, which requires the Commission to

> "give due consideration, among other things, to the transportation needs of the country, and the necessity (under honest, efficient, and economical management of existing transportation facilities) of enlarging such facilities in order to provide the people of the United States with adequate transportation."

The Commission and its counsel neglect to state that this direction is in that paragraph of Section 15a which con-

fers upon the Commission power to determine from time to time the reasonable rate of return. No such direction occurs in those paragraphs relating to the determination of value, which the Commission is directed to find by giving due consideration to all the elements of value recognized by the law of the land. The inference is plain. Congress intended that the actual value of each carrier should be determined by a consideration of all relevant facts and circumstances, and that the aggregate value of the railroads should be the sum of these separately established values; but intended that in determining a fair rate of return on such value, the Commission should give consideration to the necessity of attracting new capital in order to maintain an adequate national system of transportation.

(b) REASON, AS WELL AS THE EXPRESSED INTENT OF CONGRESS, SUPPORTS THE VIEW THAT, WHILE ABILITY TO ATTRACT CAPITAL IS A MATTER TO BE TAKEN INTO ACCOUNT IN DETERMINING THE PROPER RATE OF RETURN UPON AGGREGATE VALUE WHEN FOUND, IT HAS NO BEARING UPON THE DETERMINATION OF EITHER THE VALUE OF A PARTICULAR PROPERTY OR OF THE AGGREGATE VALUE OF ALL RAILROAD PROPERTY.

It is difficult to perceive upon what theory the value of existing property is dependent upon the ability of the owner to attract new capital for the enterprise to which it is devoted. On the contrary, ability to attract new capital, or credit, of a railroad as of any other going concern, rests upon the value of its property and its present and prospective earning capacity or rate of return thereon. Logically, it would appear that value of railroad

property, like the value of all other property, should be determined by a consideration of all relevant facts and circumstances and should be measured in terms of dollars of present purchasing power. The fact that railroads are not bought and sold like horses and mules is of no significance. Neither are the physical properties of any other large corporation. Mergers may be effected through exchange of securities but the property of either is rarely sold for cash.

The value of a locomotive, car, rail, bridge, building, or piece of real estate owned by a railroad company is no more dependent upon the ability of that company to attract new capital with which to buy more cars, locomotives or real estate, or to erect more bridges or buildings, or to build more tracks, than is the value of any other physical property. The Transportation Act provides that the actual value of railway property, like other property, is to be determined in each case by a consideration of all relevant facts and circumstances, and the rate of return shall be such as to attract new capital to the industry and thus preserve a national system of transportation. For this rational scheme of regulation the Commission would substitute a wholly irrational scheme in which there would be no distinction between the considerations governing the determination of value and the considerations governing the determination of a fair rate of return. Under its interpretation of the law, the two are to be determined together, and in such a way as to render it impossible to distinguish between the considerations governing the determination of value and those governing the rate of return. Determination of both is made to rest upon considerations of administrative and legislative expediency.

8. The effect and purpose of the test relied on is to prevent effective judicial review of the valuation of public utility properties by either federal or state commissions.

The considerations which, according to the Commission's brief, actuated it in determining the value of this property are all considerations of administrative and legislative policy governing the fixing of rates. The determination of these questions is within the field of administrative and legislative discretion. While the fixing of rates, however, is a legislative function, the determination of whether such rates involve confiscation, and of the value of the property upon the basis of which such determination rests, is a judicial question. The Commission would make the determination of value depend upon considerations of administrative and legislative policy, and thus put it wholly within the administrative or legislative field, without effective judicial review. There would no longer be any standard according to which judicial review could be exercised.

If value was of no importance except in the fixing of rates, the Commission might arrive at results which would be fair to the railroads, by exercising its discretion in respect of value as it exercises its discretion in respect of rates, or as it is permitted by statute to exercise its discretion in fixing a fair rate of return. But it should be noted that the Commission is invested with no discretion in respect of the recapture of excess earnings. The carrier is under the duty of paying to the United States one-half of the amount by which such earnings exceed six per cent. of the value of the property. The Commission has

no authority to determine what is "fair" for the Government to take or the carrier to retain. For the purposes of recapture, therefore, it is important that value should be determined by legal standards, and ascertained as a fact, and not fixed upon the basis of considerations of legislative and administrative policy, with a view to securing a rate level that will be satisfactory to the public and not injurious to the railroads.

9. The order of the Commission could not be supported upon the basis of these considerations, even if they were pertinent, because they rest upon conclusions of fact assumed by the Commission without proper inquiry and without evidence.

(a) THE ASSUMPTION THAT THE AGGREGATE VALUE OF ALL RAILWAY PROPERTY, DETERMINED IN ACCORDANCE WITH THE METHOD PURSUED IN THIS CASE, WILL COINCIDE SUBSTANTIALLY WITH THE COMMISSION'S SUMMARY VALUATION OF ALL RAILWAY PROPERTY IN 1920, UPON WHICH THE CURRENT RATES ARE BASED, IS WITHOUT ANY SUPPORT IN THE RECORD, AND THE RELATION BETWEEN THE TWO IS ONE INCAPABLE OF PRESENT DETERMINATION.

The Commission would determine the value of all railroad property by adding the actual cost of additions and betterments to its valuation of pre-war property under Section 19a. The present case was decided by the Commission on February 15, 1927. On December 31, 1926, the Commission's valuations under 19a had become final in respect of but 17,974 miles of railroad, or 7.3% of the total mileage (40th Annual Report of the Commission,

1926, p. 14). Tentative valuations had been served on 65.67% of total mileage (*ib.*, p. 13), each of which was subject to protest and hearing. On December 31, 1928, the percentage of the mileage of which final valuations had been reported increased to 34.35%. The relation between aggregate value under the method pursued in this case and the summary valuation made in 1920, plus subsequent additions and betterments, upon which existing rates are based, was not, at the date of the report, and is not now an ascertainable fact.

(b) THE ASSUMPTION THAT RATES HIGHER THAN THOSE NOW CURRENT WOULD BE PRODUCTIVE OF PUBLIC HARDSHIP IS A MERE EXPRESSION OF OPINION, BASED ON NO EVIDENCE, AND OPEN TO CONTROVERSY.

In the carriers' opening brief it was stated that, although the Report suggests that unfavorable economic consequences might arise *if* rates were advanced so as to afford a fair return upon aggregate value determined in respect of every railroad by giving full weight to current reproduction costs, it appeared on the face of the report that the Commission itself did not anticipate any unfavorable economic consequences from adherence to the present value rule. The suggestions made in the report were characterized as a "scare" argument containing no scare. These assertions are not seriously challenged by opposing counsel; but the scare argument is repeated.

In a further effort to exaggerate the possible, although improbable, effects of such rigid adherence to cost of reproduction in every case, the Commission states (Commission Brief, p. 68) that an increase of 18% in rates

would be required to bring the return of the carriers up to a fair rate of return on an aggregate value so determined. This is based on the assumption that the increase in value would be 60%,—an assumption for which there is no support in the record,—and upon the further assumption that the net railway operating income of the carriers is now 30% of their gross operating revenues, so that to increase the net 60%, it would be necessary to increase the rates, and thus the gross, by 30% of 60%, or 18%.

The use of 30% is erroneous, as clearly appears from the Commission's own reports,[1] and is based upon the use of operating expenses instead of net railway operating income, in computing return on investment, as is indicated in the margin.[2]

Therefore, even assuming the 60% increase referred to, it appears that the maximum estimated increase in rates would be from 10% to 12%, and not 18%, as stated in the Commission's Brief.

Furthermore, the suggested possible advances, although running into the millions, must, to be seen in their proper

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[1] As shown in the carriers' opening brief (pp. 9-10), the aggregate net railway operating income of all American railroads in the year 1926 was not 30% but a little less than 20% of aggregate operating revenues. For the year 1927, the net railway operating income, $1,077,842,000 (42nd Annual Report of the Commission, 1928, Table V, p. 113) was but little more than 17% of total operating revenues of $6,136,300,000 (*ibid.*, Table VI, p. 115).

[2] The operating ratio of 73.15% for 1926 to which the Commission's brief refers, as appears from the Annual Report (Table VI, *supra*), is the percentage which operating expenses alone are of gross revenues. It does not include taxes, hire of equipment or joint facility rents, which are a part of the charges deducted before net railway operating income, on the basis of which return to the investment is determined, is ascertained.

perspective, be placed in their proper setting. The net value of all agricultural products produced within the United States in the year 1927 was $9,816,000,000 (Dept. of Agriculture, "Crops and Markets," July, 1928, p. 267 Table 1), and of mineral products $5,520,000,000 (Bureau of Mines, "Mineral Resources of U. S. in 1927," preliminary summary published Aug. 13, 1928, p. A5); the value of manufactures was last reported at $62,714,000,000 (Dept. of Commerce "Census of Manufactures, 1925," p. 14), making a total of $78,050,000,000.

On the basis of its exaggerated estimate, above referred to, the Commissions suggests that 11 billion should be added to the value of the railroad properties if full effect, instead of no effect, were given to cost of reproduction. Assuming this to be so, the rate of return on such amount, figured at 5¾%, would be $632,500,000. Assuming an increase in railroad rates of this amount, such increase would still be considerably less than 1% of the total value of the agricultural, mineral and manufactured products of the United States. In the light of these figures and of the restraint resulting from self-interest and from the Commission's power to see that individual rates are just and reasonable, an acceptance of the Commission's suggestion of possible, although improbable, unfavorable economic consequences, based upon its mere *ipse dixit*, and without inquiry, would be wholly without justification.

(c) THE ASSUMPTION THAT THE AGGREGATE VALUE OF ALL RAILWAY PROPERTY, IF DETERMINED BY THE METHOD EMPLOYED IN THIS CASE, WOULD BE ADEQUATE TO PROTECT THE CREDIT OF THE RAILROADS AND BRING NEW CAPITAL INTO THE ENTERPRISE ON FAVORABLE TERMS, IS THE ASSUMPTION OF A FACT IMMATERIAL TO THE QUESTION AT ISSUE, UNSUPPORTED BY EVIDENCE, AND MADE WITHOUT INQUIRY.

If, under the doctrine adduced by the Commission, value is to be fixed at the lowest point necessary to yield a return that will attract new capital, then clearly it is a question of fact to be determined upon evidence and after inquiry. The Commission conducted no such inquiry. The record is devoid of any such evidence. The inferences to be drawn from public records, of which the Court will take judicial notice, are seemingly at variance with the Commission's conclusions. The Commission proceeds upon the assumption that aggregate values so determined will approximate the summary valuation placed upon the property in 1920, plus subsequent additions and betterments. It proceeds upon the assumption that the net railway operating income derived from such rates has been and will be adequate to attract new capital on favorable terms. It says that the credit of the carriers has improved since the passage of the Transportation Act. So it has. Their revenues then were barely sufficient to pay operating expenses, and a substantial increase in rates was recognized as necessary. It says interest rates have declined. So they have, in respect of money borrowed not only by the railroads but by all other borrowers of money. To attribute the decline in interest rates to the Commission's administration of the Transportation Act

is to shut one's eyes to the whole course of the investment market in the post-war period. It says that $4,000,000,000 has been added to the capital investment of the railroads since the passage of the Transportation Act. So they have. The period has been one of great surplus of investment funds, which have found their way into railroad securities as well as into other classes of securities.

The real test of the ability of the carriers to continue to attract capital on favorable terms lies in the relative attractiveness of railroad investments as compared with others. Railroads obtain their new capital in competition with all other forms of industry. The Commission says:

> "The credit of the railroads in general is now excellent and the time seems to be approaching rapidly when many of them will be able to finance not only through bonds and notes but by issues of new stock. Already some of them are financing their needs in this way" (R., 67, Commission Brief, p. 110).

In making these statements, however, the Commission recognizes the desirability of financing through the sales of stock and keeping down the ratio of funded debt to total capital, if credit is to be maintained and capital attracted on the most favorable terms. It appears from the Commercial and Financial Chronicle that while the railroads between January 1, 1920, and December 1, 1928, issued new securities in the amount of $3,959,540,576, the public utilities issued new securities in the amount of $10,698,196,682, and industrial corporations in the amount of $17,137,038,022. Of the new capital raised by railroads

through the sale of securities, but 7.86% was raised through the sale of stock, while 34.9% of the new capital funds raised by public utilities, and 32.5% of the new funds raised by industrial corporations, were raised through the sale of stock.*

Despite the rosy picture painted by the Commission, funded debt which on December 31, 1917, immediately preceding federal control, was 54.5% of total capital, had grown, on December 31, 1927, to 56.3% (42nd Annual Report of the Commission, 1928, Table III, p. 112). The total investment in the same period has grown from $18,574,297,000 to $24,453,871,000 (*ibid.*, Table V, p. 113), an increase of $5,879,574,000. During the same period the net railway operating income has increased from $950,556,000 to $1,077,842,000, an increase of $127,286,000 (*ibid.*). Thus in 1927, the rate of return on new money invested in the enterprise since 1917, was a trifle over two per cent.

In the carriers' opening brief it was pointed out that despite the expectation that the railroads would or should receive more generous treatment after the war, their rate of return on investment was materially less than in the ten year period prior to the war. In the face of these figures, any belief of the Commission that the time is rapidly approaching when, in competition with other forms

*See Commercial and Financial Chronicle of January 27, 1923, page 346, listing stock and bonds sold by the railroads, public utilities and industrials respectively 1920 to 1922; Commercial and Financial Chronicle of January 21, 1928, page 308, giving same information for period 1923 to 1927, and Commercial and Commercial and Financial Chronicle of December 15, 1928, page 3313, showing stock and bond sales of the three classes of corporations in the year 1928. The figures in the text are a consolidation of the amounts stated in these three issues of the Chronicle, together covering a period from January 1, 1920 to December 1, 1928.

of investment, the railroads generally will be able to finance through the sales of stock, is without foundation in fact. It would also appear from the foregoing figures that there is no substantial basis for the lurid picture of extravagant profits which might be realized by railroad stockholders if railroad property, like all other property, were valued in terms of dollars of present purchasing power.

These considerations, we repeat, have no place in a recapture case where the issue is not what the rates should be for the future, but the extent, if any, to which net income already received at current rates exceeds six per cent. upon the true value of the carriers' property. Clearly, however, if the value of this railroad is to be determined, not by a consideration of relevant facts and circumstances pertaining to it, but by a consideration of aggregate earnings necessary to attract new capital into the railroad industry as a whole, the figures recited are sufficient to show that the conclusions of the Commission may not be supported by its mere *ipse dixit*, but relate to a subject matter in respect of which a decision may be reached only after careful inquiry and upon substantial evidence.

We believe that the argument of the Commission and the Conference is shortsighted. It views the problem of railroad credit from a standpoint of temporary expediency. It is equivalent to saying that the owners of the railroads do not have the constitutional protection of their property, and the right to a return on its actual value, which the doctrine of *Smyth* v. *Ames* gives them, and which the Transportation Act was intended to recognize. No greater blow could be given to the credit of the American railroads than a decision of this Court accepting their position.

10. The theory of administrative and constitutional law advanced by the Commission and the Valuation Conference is revolutionary, in that it asserts that the determination of value under Section 15a is a mere administrative question to be determined on the basis of considerations of public policy and convenience, and not a judicial question, and in that it asserts that the function of the courts is solely to decide whether the Commission's determination was a proper expression of public policy, without any regard for the value of the property rights of the railroad.

The Commission and the Valuation Conference assert in effect that it is the Commission's right to exercise legislative powers free from constitutional and statutory limitations as administered by the judiciary. Both regard the determination of value as an administrative function. This case, arising under the specific terms of Section 15a, is treated as though it involved the legislative problem of making reasonable rates. The question of value is treated as an administrative question, involving the determination of a proper public policy. In this field the Commission is to be practically supreme. The courts cannot interfere and substitute their judgment upon a matter of public policy. These theories underlie a substantial part of the discussion in both briefs (Commission, pp. 72-6; Valuation Conference, pp. 2, 6; Point 3, p. 7; Point 5, p. 9; Part III, pp. 23, 39, 72).

Such a conception would reorganize the entire structure of the law. The determination of reasonable rates has always been regarded as a legislative function. As to matters of mere legislative policy the courts have not

been authorized to substitute their judgment. But the determination of the constitutional limitation upon administrative policy arising out of the protection given by the Fifth and Fourteenth Amendments to the value of property has always been regarded as a judicial question, as the cases cited in the Conference brief on page 63, disclose. In this case the constitutional right is invoked. Also, the right of judicial review of the order is invoked to test the Commission's statutory authority. These are plain judicial questions. The challenge of the Commission and the Valuation Conference of the right of the court to apply judicial tests to the determination of value under these circumstances is entirely without support in any existing law. In fact the spirit of the two briefs is one of challenge of the existing law.

In order to justify this extreme position by a process of rationalization and to excuse the obvious infringement of constitutional and statutory rights, it is necessary to explain away the basic principles upon which the theory of the protection of these rights has been grounded. Consequently, the Commission and the Conference object to the test of the actual *value* of the property prescribed by *Smyth* v. *Ames* and stated under Sec. 15a. They deny that their owners have property rights in the railroads and that there is any property value to be protected. The plain language of Sec. 15a is to be avoided by means of rules of law which, because of indefiniteness, give the Commission an uncontrolled dominion over the railroads. The recommendations of the Commission and the Conference as to the rule to be substituted for *Smyth* v. *Ames* are not exactly the same, but each leaves the railroads "at the mercy of legislative caprice" (59).

(a) THE COMMISSION'S INTERPRETATION OF "VALUE" AS USED IN *Smyth* v. *Ames*, AS PERMITTING THE COMMISSION TO EXERCISE ITS LEGISLATIVE DISCRETION IN DETERMINING THE SUM UPON WHICH IT IS "FAIR" TO ALLOW A RETURN, WITHOUT ANY REGARD FOR THE ACTUAL VALUE OF THE PROPERTY, JUDICIALLY DETERMINED, IS WITHOUT ANY SUPPORT IN LAW OR REASON.

In order to reach the conclusion that its finding of approximate investment is consistent with "value," as prescribed and defined by this Court, the Commission takes the position that the Court has not meant by "value" the real value of the property as its economic equivalent. Just what the Court meant is said to be a thing of such a vague nature that it is not even subject to *definition* but can only be "described" (statement of former Commissioner Prouty, Brief, p. 89). It is said to be an "*artificial* judicial concept" essentially different from the economic concept, but meaning merely what in the judgment of reasonable men is just and right (pp. 89-90).

> "It is only by recognizing that 'value' as used in railroad rate regulation cases has a special and peculiar significance unknown to economists and described as 'fair value' or 'value for rate making purposes' that any hope of a rational determination of the rate base can exist. Even this hope must fade unless the final determination of rate basis of value for rate making purposes is to rest upon the judgment of an expert Commission (protected by the Court from abuse) as to what will constitute 'fair' treatment *in a broad and just view of public policy* * * *" (p. 87).

The same proposition is stated on pages 90 and 91. Having decided that the railroad has no property rights, and that "value," as used in *Smyth* v. *Ames*, is of such a vague and illusory nature that it can be described but cannot be actually defined, the Commission would have itself regarded as supreme in the field of broad equitable considerations of public policy, unchecked by judicial or constitutional checks. "Value" is thus so defined that any finding, however inadequate, may be said to be within its limits. Having thus interpreted *Smyth* v. *Ames*, the Commission's brief regards its order as complying with the law (pp. 39-40, 112-113). Such an interpretation of the law means a retrogression to the chaos which preceded *Smyth* v. *Ames* and which that decision was intended to prevent and has effectively prevented, in spite of the repeated attempts of the Commissions to reverse that decision.

This order is attacked because of the nature of its finding rather than because of the language in which it is either expressed or defined. It is substance and not appearance, that is to be tested by this Court. A finding of what is *called* "value," determined with a declared purpose of ascertaining, as nearly as possible, the original cost or prudent investment, is not validated by labeling it a "*fair* value for rate making purposes." When determined, with a declared purpose of disregarding the higher costs and values existing at the time of the issue, it cannot, by mere form of designation, be changed into the true present value of the property. The suggested test of the Commission, as it admits, is so vague that it cannot be defined, but can only be described. It is "that

sum upon which under all the circumstances and upon a *fair* consideration of all the facts and elements to be taken into account, a *fair* return should be permitted" (p. 89). The Commission declares that the controlling factor in the last analysis is "what is *just* and in harmony with a sound public policy," there being no "abstract standard of justice that can be applied" (Brief, p. 90). What is "fair" is all things to all men. What is "just and in harmony with a sound public policy" depends entirely upon the complexion of the Commission that decides it. The theory of constitutional limitations rests on something more substantial. Its theory is that the constitution, as interpreted by the Court, prescribes a minimum standard of justice marking the limit of confiscation, and that the particular whims of the legislative mind as to "what is fair" shall be limited by substantive rights. The proposal of the Commission is that it should not be enjoined in violating the plain language of Sec. 15a, because it regards it as "fair and just" and "good public policy" not to obey the law.

(b) THE THEORY OF THE CONFERENCE COUNSEL IS UNSOUND BECAUSE IT SIMILARLY VESTS THE COMMISSION WITH UNCONTROLLED LEGISLATIVE POWER.

The proposals of the Conference counsel are similarly sweeping and revolutionary. He proposes a judicial test of confiscation described in such vague generalities as to defy analysis. The brief openly attacks the present interference of the courts with the legislative power of rate regulation. Objection is made to any attempt on the part of the courts to "coerce" the exercise of legislative discre-

tion by the establishment of definite rules as to what is fair and reasonable, it being said that to do so "is simply an attempt to destroy the substance of legislative power" (71-2, Point V, p. 39 *et seq.*). The Commission is to act in a field which is described in these generalities:

> "Even where there is active competition, a study of existing market prices must be qualified by a judgment as to the fairness of competition, and the extent to which the bargaining power of sellers or buyers may have been aided by temporary, unfair conditions or by unjust use of political or economic power. Like every ethical problem presented for discussion and opinion, there must be taken into consideration the balancing and compromising of conflicting interests, the shifting currents of public and private interests, the necessities which arise from human weaknesses and incapacities; and the uncertainties which thwart all efforts to determine what are the ideal uses of human strength and capacity" (pp. 70-71).

We find no suggestion of any definition of the power of the courts to restrain the Commission in the vaguely defined field of considerations thus described. Nor do we find, as illustrative of the proposed scope of the judicial authority, any definite test suggested to be employed by the Court in this particular case. It is suggested that the Commission's conceptions of public policy should be approved because the railroads are prosperous. In the latter portions of the brief it is urged that the Court should not interfere with the Commission but should affirm its determination, for the simple reason, apparently regarded as sufficient, that it is "a permanent commission of recognized ability of long experience and tested

responsibility," has given great consideration to these problems and presumptively has reached a conclusion which is a proper expression of public policy (p. 121). This is in face of the fact that the Commission did not attempt to determine the actual value, as the statute required, and thereby refused to follow the public policy expressly declared by the Transportation Act, which as this Court has recognized in the series of cases beginning with the *Dayton-Goose Creek* case, established a system of regulation expressing a new governmental policy. Thus, the Conference counsel would have the Commision independent, not only of the courts, but of Congress.

(c) THE PROPOSITION THAT *Smyth* v. *Ames* AND THE PROVISIONS OF SECTION 15A ARE UNSOUND BECAUSE THEY ASSUME THAT THE OWNER OF PROPERTY DEVOTED TO PUBLIC UTILITY USE HAS RIGHTS OF PRIVATE PROPERTY THEREIN AND THAT THEIR ACTUAL VALUE CAN BE EMPLOYED AS THEIR MEASURE, IS UNSUPPORTED IN REASON OR AUTHORITY.

For a defense of action attacked as violating statutory and constitutional provisions protecting the *value* of *property*, the Commission and the Conference are driven to a denial of the existence of the property rights, and of value as a sound and judicial conception. This is a basic attack on the fundamentals of the *Smyth* v. *Ames* rule and on the specific valuation provisions of Section 15a. It is consistent with the statement in the Commission's report to the effect that railroad valuation may be regarded as opening a new chapter in the law of public utility regulation, as a result of which the established conceptions may well be abrogated. It is a pro-

posal that the necessities of the situation require a reorganization of the judicial conceptions of constitutional restraints on railroad regulation, as developed by this Court, and that the Court retrace its steps to the position adopted in *Munn* v. *Illinois*, 94 U. S. 113.

In its essentials, it is the position stated by Chief Justice Waite in that case, that the business of a common carrier is affected with a public interest, that the owner who devotes property to such service virtually vests a title therein in the public, and retains no rights which the courts will effectively protect, as a consequence of which "for protection against abuses by legislatures" the interested parties "must resort to the polls, not to the courts" (p. 134). The vigorous dissent by Justice Field recognized that this doctrine was, in effect, that the power to regulate is the power to destroy, and would result in chaos and the ultimate destruction of the public utility business. This became apparent when the attacks on the railroads resulting from the granger movement were sustained under the theory of *Munn* v. *Illinois*. It is not necessary here to review the development of this conflict of principles through the subsequent cases, such as *C. B. & Q. R. R. Co.* v. *Iowa*, 94 U. S. 155; *P. Peik* v. *C. & N. W. Ry. Co.*, 94 U. S. 164; *Railroad Commission Cases*, 116 U. S. 307, and *Reagan* v. *Farmers' Loan and Trust Company*, 154 U. S. 362. The conflict culminated in *Smyth* v. *Ames*, 169 U. S. 466. As a consequence, the law expressed a proper application of the theory of the balance of power between the legislative and judicial branches of the government, reflected a recognition of the existence of private property in common carrier utilities, and established the doctrine that the *value* of the property is a proper basis for the

application of constitutional safeguards. The validity of every one of these steps is denied by the briefs of the Commission and Conference counsel.

(d) THE ARGUMENT THAT THE OWNER FORFEITS HIS RIGHTS IN PRIVATE PROPERTY WHEN HE DEVOTES IT TO PUBLIC SERVICE AND IS THEN VIRTUALLY AT THE MERCY OF LEGISLATIVE CAPRICE, RESTS ON A MISCONCEPTION OF THE LAW OF PROPERTY RIGHTS.

The briefs of both the Commission and the Conference counsel frankly accept the burden of establishing that the doctrine of *Smyth* v. *Ames* is predicated on a false juristic conception of the property rights involved, because it assumes that the property of a public utility is private property. It is argued that since its earnings are subject to regulation and it does not have the power to determine the price of its product, the plant with which the product is produced is not private property, and can not be valued as such. A large part of the brief of the Conference counsel[1] is devoted to this thesis and the point is made to the same effect in the brief of the Commission.[2]

Without discussing the precedents in detail, the proposition thus advanced, as we have stated, was the fundamental basis of the doctrine of the decision of *Munn* v. *Illinois* and is necessarily denied by the decision in *Smyth* v. *Ames*. In *Ames* v. *Union Pacific Railway Company*, 64 Fed. 165 [which is the case of *Smyth* v. *Ames* in the lower court and the theory of which the Supreme Court sus-

[1]Point 4, pages 6-7. Argument, page 24 *et seq*. Appendix A, pages 127-177.

[2]Pages 82-83, 84-6, 149-156.

tained], Judge Brewer discussed the point at length and recognized the rights in private property involved [pp. 176-7]. As explained in detail in our opening brief (pp. 79-80) the nature of the property rights of the railroads was one of the basic issues in the *Minnesota Rate Cases*, 230 U. S. 352, and the Court held that railroad property "is held in private ownership and it is that property and not the original cost of it of which the owner may not be deprived without due process of law" (p. 254). In *San Joaquin* v. *Stanislaus County*, 233 U. S. 454, the Court again repudiated the proposition that the property rights of the utilities were not to receive full protection because not rights in private property [p. 460]. The Court has held to a similar effect in a great variety of analogous cases.[1] Since the argument of the Commission and the Conference, however, is a denial of the validity of the rule thus firmly established, it is not to be answered by mere precedent.

The conception of property as a "bundle of rights," which is employed by the Conference counsel, is merely a convenient means of expressing the congeries of rights, powers and privileges which together constitute "title" or "property." As a matter of substantive law, it is for this Court to decide what those rights are. The constitutional

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[1] *Railroad Company* v. *Peniston*, 18 Wall. 5; 1 Redfield, *Law of Railways*, 531; *Wilmington Railroad* v. *Reid*, 13 Wall. 264; *Reagan* v. *Farmers' Loan and Trust Company*, 154 U. S. 362; *Consolidated Gas Company* v. *City of New York*, 157 Fed. 849; *Lake Erie and Western Railroad Company* v. *Weitham*, 155 Ill. 514; *Western Union Telegraph Company* v. *Pennsylvania Railroad*, 199 U. S. 540, 549, 573; *Northern Pacific Railway Company* v. *Townsend*, 190 U. S. 267; *Rio Grande Ry.* v. *Stringham*, 239 U. S. 44; *Board of Public Utility Commissioners* v. *New York Telephone Company*, 271 U. S. 23.

right to protection against confiscation has always been one. This right is now attacked. The reasoning employed merely begs the question. It denies the constitutional right of protection against unlawful regulation, upon the ground that there is a power of lawful regulation.

Proper analysis indicates that the property rights of the owner of public utility property are not less than those constituting the title of so-called "private" property. The business of common carriage is "affected with a public interest" because of the nature of its service, and its consequent dominion over the necessities of human life. The railroad has been regarded as performing a function of the state. [Cases cited Commission's Brief, pp. 82-3, 149-156.] Therefore when a railroad company is chartered, the granting of powers not given to a company engaged in ordinary private business, is justified. It is empowered to carry on a quasi-public work, which the state might well perform. It is vested with a power of eminent domain as though an agent of the state. While not properly elements of value in a controversy involving rates, these important rights must be considered in any argument based on the bundle of rights theory. They add to the bundle.

The duties of public service which the utility assumes, cannot be said to decimate its rights so that, unlike a private carrier whose property would be protected in the full measure of the law, the common carrier retains nothing which the law protects. When it undertakes its threefold duties of serving the public without discrimination, with reasonable services and at reasonable rates, it submits to governmental regulation intended to insure the performance of these duties. That regulation does not

destroy all rights of private property, any more than does any police power regulation of any business. Regulation insures the right relationships with the public, which are, for private business, insured by competition. But the legal title to the utility's land or cars is not so reduced that the Constitution finds nothing to protect, whereas it would give full protection to the same property if owned by a private carrier. The power to regulate is not the power to destroy.

Any elements of value arising from the utility's domination over human necessities or from the right of eminent domain, are not to be considered in a valuation of railroad property for rate making purposes. But the argument that its property has no real value, because the utility must perform its legal duties to the public, is equally invalid. It is an argument exactly in kind. The proposition that the property is without title or value because devoted to the performance of a public function, is as unsound as the proposition that the property of the utility, as an agent of the state, is beyond its regulation, and has a high value because of its important functions.

While the *business* of a common carrier is "affected with a public interest," the statement that its "*property* is affected with a public interest," cannot be taken literally. This is clear from the repeated decisions that the property of a common carrier is private property. All established conceptions must be changed if the coal cars of the O'Fallon are not private property. They are the private instrumentality with which a business, affected with a public interest, is conducted. While the service is public and must continue, the cars are private property and could be sold tomorrow. The view that there is no

private property in a utility fails to distinguish between an impairment of the legal title by another adverse title, (as where a fee is impaired by an easement), and the effect upon the ownership of property of mere police power regulations which, in the case of railroads, are primarily directed at the business rather than at the property employed. A requirement that a owner of land, with uses it for a business, pay an income tax, or that he refrain from a combination in restraint of trade whereby he may charge exorbitant prices, does not make his land other than private property. Nor does the recapture clause, which is similar to an excise ordinance, so affect the property of a railroad. The coal from the mines on the O'Fallon railroad might have been hauled by a spur track privately owned and operated, instead of by the O'Fallon as a common carrier. Had such a property been built in 1920 at a cost of $1,350,000, and had a value in that amount, the law would have protected that amount were the issue raised in a condemnation suit, even though an income tax reduced the earnings of the owner of this private railroad so that the money he retained constituted a fair return on only half of the value.

As society becomes more complex, more phases of human relationship must be regulated and laws are multiplied. These police power regulations are not regarded as a taking of property. In general, they create value, rather than destroy it, because they are regulations for the common good. They act in a correlative way, creating rights as well as duties. Consequently, rights in private property are not less in a civilized community than in the vigilanti days of a frontier state. The regulation of the railroads, intended to stabilize and protect

the business, by imposing certain duties on the utility toward the public, as well as duties on the public toward the utility, has sustained, not destroyed, the rights in private property.

If the theory of the Conference counsel is sound, it is equally applicable to all private business. Thus a company engaged in supplying food for human consumption in a civilized country, as distinguished from Patagonia where we assume there are no such regulations, ceases to have a bundle of rights enabling it to protect itself against a destruction of its property and business, merely because it is subject to such laws as pure food, meat inspection, sanitation, building, safety, zoning, speed, quarantine, anti-trust, employers' liability, anti-rebate, blue sky, usury, and other police power regulations. Each is a subtraction from the bundle. The same fallacy underlies the theory that prompts the view that liberty is license, and cannot really exist in a civilized community where human relationships are constrained by law.

It is for this Court to determine what the rights of the owner of property are. It is a matter for judicial determination and the decision rests in the fundamental juristic conceptions of what rights, if any, are to be recognized by our government in this particular kind of property. The soundness of the proposal is to be judged in part by its consequences. The issue, as it has been interpreted by this Court since the case of *Munn* v. *Illinois*, is whether the legislature is to have supreme power over the property of a public utility or whether its rights are to be protected against unreasonable incursions of the legislature. The question involved is one to be decided, we believe, with

regard for the fundamental genius of American institutions. Has the individual any rights as against the state where the state desires unchecked powers of control? The Commission, the Government, and the Valuation Conference, are not able at this time to point to any national emergency as a result of which this final step in the destruction of the rights of private property in utilities shall be taken. The reasons urged lie in considerations of mere administrative expediency, convenience and expense, and this Commission's own conceptions of public policy, which, it happens, are directly adverse to the policy of protecting the *value* of utility *property* declared by Congress in the Transportation Act, which it is the duty of the Commission to administer.

(e) THE ARGUMENT THAT *Smyth* v. *Ames* REQUIRES THE USE OF A FALSE ECONOMIC CONCEPT OF VALUE WHICH IS NOT SUSCEPTIBLE OF RATIONAL DETERMINATION IS UNSOUND.

The proposition that the rule of *Smyth* v. *Ames* is based on a "false *economic* concept of 'value' " is a natural corollary to the proposition that the rule is based on a "false juristic concept of 'property.' " The Commission's brief argues that, because of the public nature of railroad property, no ordinary methods of valuation will apply; that *Smyth* v. *Ames* prescribes a false conception of value which is "unknown to economists," and that "value" as pertaining to private property is not susceptible of rational application to utility property (pp. 86-7). The Commission's brief quotes economic opinion to the effect that the use of value is not consistent with academic conceptions and rests on fallacy (88).

The point is similarly developed at length by the Conference counsel (pp. 6-8, Argument, p. 23, *et seq.*). It is argued by the Conference counsel that "value" as used in *Smyth* v. *Ames* is a false economic conception, and that the only actual value which the railroad property can have is that which *results* from the legislative fixing of rates.

The concept of "value" as used in *Smyth* v. *Ames*, is declared invalid, because not consistent with a particular definition of "value," which is stated without legal authority as the "power to command a price" (p. 33). Having thus established a supposed definition of "value," a large part of the argument is devoted to the point that this particular kind of value cannot be the basis of regulation because the carrier does not have entire power to regulate the price of its product, that power being in the Government, and consequently does not have the power to command a price for the plant with which the product is produced. The definition of "value" as a "power to command a price" is stated as though it were the right definition, although the brief inconsistently argues at length that there is no such thing as *one* true value, that value itself differs under different conditions and for different purposes (pp. 14-17), and that the economic theorists have been unable to agree among themselves upon a theory of value (p. 18).

This sort of reasoning in a realm of economic theory, based on conceptions of the academicians, invests this problem with a difficulty which is unreal. The difficulty is resolved when one reasons concretely. A great part of the O'Fallon property here in question is coal cars. They sell in the market, and their value can be readily de-

termined. Has their value been placed outside the realm of rational ascertainment, by virtue of the fact that the rates of the O'Fallon are subject to regulation? The rest of the property is not different. Were the City of St. Louis condemning a warehouse or machine shops similar to those owned by the O'Fallon, the supposed uneconomic nature of the conception of value, which would be the basis of the determination, would not prove an insuperable obstacle to the practical working of the law. Were the same property owned by the O'Fallon, the problem would be no different. Were a levee company to condemn the right of way embankments of the O'Fallon for levee purposes, their actual value would be ascertained without difficulty. Were the value of all the O'Fallon property the subject of a controversy in a condemnation case, or in a case involving value for the purpose of determining the loss under insurance, justice would not be frustrated by any such theoretical considerations. The determination of the actual value of the property of the railroads of the country may present a problem requiring the exercise of intelligent judgment. The evidence may be difficult to secure. But such considerations are mere considerations of convenience. From the standpoint of fundamental juristic conceptions the theory of *Smyth* v. *Ames* requiring that the *value* be the basis of determination is fundamentally sound and practicable.

Any conclusion that the problem of ascertaining its actual value is irrational or impracticable must be reached not by a consideration of the problem itself but by reasoning itself impractical. The same line of higher criticism would make impossible and unlawful the basis of determination actually employed in thousands of cases involv-

ing the value of real and personal property. The thing important in this controversy is not mere terminology, or definitions of "value" in the language of economic professors or others, but the substantive idea adopted by the court as the measure of the rights in question. The rule of *Smyth* v. *Ames* defines the *value* as the measure of the physical property. This is a conception not essentially different from that employed in a wide variety of cases where the *worth* of a thing is made the basis of the adjustment of a controversy, and where it is to be determined by a court or jury as a matter of judgment by a consideration of the relevant facts, the judgment being expressed in terms of "value," "damages," "compensation," "rent," etc., depending on the particular nature of the controversy and the aptness of particular language to express the same basic idea in accordance with the necessities of the particular case. In spite of what the economic professors may say about it, the courts for generations have efficiently settled controversies by expressing their judgment as to the economic equivalent of rights. The Conference counsel quotes with approval:

> "The 'value' of a thing is always its value for a particular purpose, and in the particular conflict, in hand at the time of valuation. Hence there is no necessary relation between any given value and cost, for cost was promoted and met by past interests which may or may not carry over into the present situation without change. The only 'true value' for the present will be the one which best resolves conflicting interests in terms of a stable adjustment" (p. 18).

Under this very conception of the situation, it is apparent that the fundamental rules established by the courts, as the result of which thousands of cases are settled by the courts and juries, involving the monetary equivalent of things injured or taken, are not void because they are not consistent with any definition of a theoretical economist of *one* standard conception of value. The law with reference to recovery for a personal injury is not to be defeated because the jury, when it determines as one of the elements of damages the value of the freedom of which the injured man has been deprived, deals with a conception of value which is inconsistent with the "primary meaning of pecuniary value, universally accepted by economists," as "the 'power to command a price,' or in other words, an 'exchange ratio' " (Brief, p. 19). The same thing is true of a great variety of similar cases where the right in question does not have an exchange value.

The Commission and the Conference complain of the conception of actual *value* as being vague as unscientific. What do they substitute? The Commission proposes a substantive test which it admits cannot even be *defined*, but which can merely be *described* (p. 89). The proposal of the Conference is equally vague. If the Commission cannot define it, how can a court do so? Can a concept which is indefinable be "described" so that any two men will recognize the idea intended? The test is described as what is "fair." But what is *fair?* The decision in *Smyth* v. *Ames* declares that it is fair that the value of the property shall be protected. The Commission and the Conference declare that is it fair that the Commission

be permitted to disregard that value. Actually, it is not the theoretical deficiencies of the value rule of *Smyth* v. *Ames* which embarrass the Commission and the Conference. It is that the decision is a practical obstruction to action greatly prejudicial to the railroads' rights.

11. The Commission's historical review of the decisions of this Court disregards the essential theory upon which they are founded.

The Commission's so-called "historical review" of the decisions of this Court (p. 139) is an attempt to wring support from the language of the various opinions, for the Commission's conclusion that the Constitution does not protect the real value of railroad property. If the analysis were correct, there would have been no such decisions as *Smyth* v. *Ames*, the *Minnesota Rate Cases* and *McCardle* v. *Indianapolis Water Co.* The doctrine of *Munn* v. *Illinois* would be the law.

The Commission's brief refers to the dissenting opinion of Mr. Justice Brandeis in the *Southwestern Bell Telephone* case, which apparently inspired the Commission in its Report, as though that opinion did not squarely present the issue between the value theory and the prudent investment theory. The conclusion is reached that "the court was united in the common conclusion reached by both a majority and the minority,"—a unanimity which the opinions fail to disclose (177). The case of *Georgia Railway & Power Company* v. *Railroad Commission*, 262 U. S. 625, is interpreted as establishing a rule which sustains the Commission's Report, and contrary to that subsequently stated in the *McCardle* case (177-8). The

brief proceeds to distinguish the latter case on the ground that the property there involved was an extraordinary property being entitled to peculiar "credit for having created and developed an excellent water supply for a large and growing city whose water resources were meager and whose need was desperate" (182), these being regarded as "very unusual facts" (185). The balance of the chapter is devoted to a criticism of this case. While the Court may best interpret these decisions, there are certain obvious distinctions which do not enter into the analysis made by the Commission's brief. The conflict in theory between the majority opinion in the *Southwestern Bell* case and the opinion of Mr. Justice Brandeis is basic and unmistakable, and the decision has been regarded by the lower courts and the bar as decisive of the question involved. While the decision in the *Georgia Railway* case has been said to be inconsistent with the majority opinion in the *Southwestern Bell* case, Mr. Justice McKenna having dissented on the ground of this inconsistency, the explanation seems to lie in the fact that the case arose merely upon a motion for a preliminary injunction and that consequently the Court, in the absence of an actual test of the rates, was less inclined to be incisive in its action. It was very uncertain, on the submission of the motion for a preliminary injunction, whether there would be any confiscation even if the current cost of reproduction had been given dominant weight. As was pointed out by the lower court (278 Fed. 242):

> "In ascertaining the present value of physical properties, though correct rules were announced by the Commission, we do not think they were exactly followed. * * * The Commission did not allow the

appreciation claimed on the investment since 1914, nor did it deduct from the investments of 1919 and 1920, which were nearly $1,000,000, their admitted reproduction loss, but it did allow the appreciation in market price of real estate. On the whole, *averaging results*, and remembering that values are at least matters of opinion, upon which witnesses and that of ourselves may be no better than that expressed by the Commission, we think no constitutional wrong *clearly appears*." (Italics ours.)

This case arose in 1922, when prices had receded from the higher levels of 1919 and 1920. The value fixed by the Commission was $5,250,000, and the lower court found the rates in question (without allowing for increased consumption which was thought probable at the lower rates) would yield 7 per cent. on $6,000,000 and 6 per cent. on $7,000,000. The accuracy of the lower court's exercise of its discretion on this motion for a temporary injunction was demonstrated by the decision on final hearing in which value was fixed on the basis of increased prices at $8,000,000 and the rates had yielded 7 per cent. on that figure (*Georgia Railway & Power Co.* v. *Railroad Commission*, P. U. R. 1925-A, 546).

The proposition that effective consideration must be given to present costs is definitely established by the Supreme Court in the *Bluefield* case and again in the *McCardle* case. The decision of the latter case is strictly consistent with the previous decisions. The State Commission had employed the split-inventory method, which has been employed by the Commission in this case. Property acquired before the war was appraised at pre-war prices and property subsequently acquired on the higher price levels was appraised at its actual cost. The *McCardle*

case is thus directly in point in every essential respect with the case now before the Court. The attempt of the Commission's brief to distinguish this case on the ground that it was an extraordinarily good property, and "entitled to extraordinary credit for having created and developed an excellent water supply for a large and growing city whose water resources were meager and whose need was desperate" (182) lays emphasis upon the real economic value of the property. In our opening brief the facts are stated which demonstrate clearly that the O'Fallon railroad is a property of extraordinary economic quality. The line of distinction relied upon by the Commission's brief to distinguish the *McCardle* case, merely establishes its applicability to the case at bar (Chap. p. 63).

The point is made (p. 187) that a thorough and complete reflection of reproduction costs in the *McCardle* case would have produced a value of about $25,000,000, whereas, in fact, a valuation of only $19,000,000 was sustained by the Supreme Court. The Commission's brief concludes, therefore, that the Court did not intend to state that full effect must be given present costs. There is no significance in that point. The carrier in the lower court had not claimed a value of $25,000,000. As appears from the foot-note on the first page of Justice Brandeis' opinion, the lower court stated that the utility offered to accept $19,000,000 as a fair basis of valuation, even though it contended (as the court agreed it reasonably could contend and prove) that the record sustained a higher valuation. The finding of the lower court that the value was *not less than* $19,000,000 was sufficient to invalidate the rates. No higher value was required for the purpose of the issue before the court, which was not primarily the value of the

property, but the validity of the rates. This Court consequently sustained the value found by the lower court. It had no occasion to do more.

12. There is no legitimate basis for a distinction between the railroads and the so-called local public utilities in point of their rights in property and the constitutional protection thereof.

The Commission seeks to escape from the necessity of recognizing as the law of the land the principles declared in such cases as the *McCardle* case, on the ground that there is a distinction in point of constitutional protection between the rights of the railroad companies and the rights of the so-called local public utilities. This is developed in a separate chapter of the Commission's brief beginning on page 91. The matter is briefly discussed in our opening brief (pp. 98-100), where statistics are stated showing the investment in the so-called local public utilities in an amount approximating twenty-two billion dollars.

The conclusion seems plain that an adoption by this Court of the views urged upon it by the Commission and the National Conference would necessarily affect the constitutional rights of the so-called local public utilities, because there is no legitimate basis for any distinction in principle. While the distinction urged by the Commission between the railroads and the other utilities is stated to rest on the fact, among others, that there is a difference, in scale and character, in the regulation of their rates, in bald terms, it seems to us merely a suggestion that the Commission would find it convenient, in regulating the railroads, to be freed from the constitutional restraints,

defined by this Court as applicable to all utility property, including railroad property.

The alleged distinction is novel. It is not supported by any decision of any court. It is contrary to the fundamental conceptions of the constitutional protection of property. The decisions in the railroad cases of *Smyth* v. *Ames* and the *Minnesota Rate Cases*, have been recognized as the law of the land and have been applied in the protection of the rights of the so-called local utilities. The converse is also true. This is because, obviously, the character of the property in both types of cases is the same. The Commission itself relies strongly on the dissenting opinion of Mr. Justice Brandeis, rendered in the case of the *Southwestern Bell Telephone Company*, itself a utility subject to the Act (Report, p. 61). Its reasoning is paraphrased in the decision of the Commission, without regard for any supposed distinction which would invalidate the reasoning for purposes of consideration in this case.

The regulation of commerce by the Federal Government under the commerce clause is subject to the limitations of the Fifth Amendment (see *United States* v. *Cress*, 243 U. S. 316, 326; *Wilson* v. *New*, 243 U. S. 332, 376; *Monongahela Navigation Co.* v. *United States*, 148 U. S. 312, 336; *Adair* v. *United States*, 208 U. S. 161, 180).

The Fourteenth Amendment operates to extend the same protection against state legislation affecting life, liberty and property as is offered by the Fifth Amendment against similar legislation by Congress (*Hamilton* v. *Kentucky Distilleries Co.*, 251 U. S. 146, 156-7; *Hibben* v. *Smith*, 191 U. S. 310, 325-326). From this it follows that decisions under the due process clause of the Fourteenth Amendment are equally applicable to the same clause

under the Fifth Amendment and vice versa. The following cases so hold: *Clark Distilling Co.* v. *Western Md. Ry. Co.*, 242 U. S. 311; *Twining* v. *New Jersey*, 211 U. S. 78; *Farrington* v. *T. Tokuskige*, 47 Sup. Ct. 406.

Property employed in intrastate commerce has, under the decisions of the United States Supreme Court, certain elements of value. These elements of value are protected against confiscation by the Fourteenth Amendment. The rule is well established that the protection of the Fifth Amendment is identical with that of the Fourteenth Amendment, excepting that the former is a protection against confiscation by federal authority. To say, as the Commission does, that the identical property when employed in interstate commerce does not have the same elements of value as it has when employed in intrastate commerce is in effect to assert that the Fifth Amendment does not furnish the same protection to property that is furnished by the Fourteenth Amendment. Such a position is contrary to the well-established rule.

13. The theory of value urged by the Government is defective in that no test of value is prescribed and the Commission is to have uncontrolled discretion.

The Act requires that the *value* be found. This the carriers assert means the economic equivalent of the property. The briefs of the Commission and the Conference deny the validity of any economic conception of value. The Commission would substitute, as we have explained, a conception of "what is fair"—a test, which admittedly cannot be defined, but which is vaguely described as a thing which will commend itself to the conscience of

fair men. The brief of the Government gives no indication that any issue lies in such considerations. It discusses the "value" of the property without definition or differentiation between economic and equitable conceptions. Not having defined value, and evidencing no concern with reference to its content or purport, it is subsequently freed from any necessity of establishing whether the so-called "value" determined is the thing that the law requires. *Smyth* v. *Ames* is discussed as establishing a mere rule or standard of evidence and not a substantive test (p. 54).

The development of the law is discussed from the standpoint of the kinds of facts considered in the various important cases without any regard for the nature of the value, to the determination of which these facts are relevant. Regarding *Smyth* v. *Ames* as not prescribing any test of constitutional rights, interpreting it as a mere rule of evidence permitting the consideration of inconsistent elements in arriving at a conclusion the nature of which is not defined, the brief readily reaches the conclusion that a Commission should be sustained in almost everything that it happens to do, since there is no binding law requiring it to make an ascertainment of any certain nature. By this process every important valuation case is actually cited as authority for the contention of the Government and the Commission in this case (p. 63). This is apparently justified on the ground that the doctrine of such cases is not "an expression of constitutional requirement". By this process, invasion of constitutional rights is justified by eliminating constitutional limitations (p. 63). The result, consequently, is the same as

that attained by the Commission and the Conference. There is shadow but no substance in utility property rights and the constitutional protection of them.

Proceeding from this hypothesis, the Government concludes that the Commission had a broad discretion in weighing the various elements of value and that that discretion will not be reviewed by the courts (p. 72). The brief, disregarding the fact that the actual "value" must be ascertained, and that this is the standard of constitutional protection, asserts that the Court in its various decisions has refused to set up either cost of reproduction or original cost as the definite standard of measurement. By this process, having eliminated all standards, the brief necessarily concludes that the Commission was practically free in its discretion to reach any result that accorded with its desires (p. 73, *et seq.*).

This fundamental error underlies the entire argument of the Government. The brief does not attempt to explain, and of course could not explain, the large number of cases where the adoption by a commission of original cost has been held invalid, because obviously the actual *value* was not reflected by such a cost. Nor does the Government recognize that in *Smyth* v. *Ames* the actual *value* was established as the test, when the carriers on the one hand were urging the original cost and when the State of Nebraska on the other hand was urging reproduction cost. Such cases are inconsistent with the fundamentals of the Government position.

Having thus eliminated the theory of actual value from consideration, and dealing solely with the *evidences* of value, such as original cost and reproduction cost, the

brief then proceeds to attempt to demonstrate that the action of the Commission in repudiating the cost of reproduction was in conformity with the intention of Congress in framing the Transportation Act (Chapter VI, p. 76). The intention of Congress is manifested in the specific language of that Act, which requires that the actual *value* of the property be determined. If, as the brief asserts, cost of reproduction as a sole basis of valuation is not in conformity with the Transportation Act, it is equally plain that the prudent investment is not in conformity with the intent of the Act and, consequently, the actual basis of the order which the brief defends, is, by its own reasoning, improper. The brief, apparently, is able to make no differentiation between the determination of an actual value, (based on such consideration of reproduction cost as the facts may justify, the weight given thereto to be determined in accordance with the quality of the property), and the arbitrary use of spot reproduction costs in all cases and under all circumstances. It argues against the latter proposition, as though it were what the carriers here advocate. The possibility of a determination of the actual value of the property, as it would be determined in a condemnation case for example, and as it is intended to be determined by the rule of *Smyth* v. *Ames*, is not considered by the argument.

The construction of *Smyth* v. *Ames* which is advocated by the Government brief, as we have said, produces the same result as the more radical interpretations of the doctrine advocated by the Conference and the Commission. The doctrine of *Smyth* v. *Ames* was promulgated as a means of curbing unreasonable administrative action,

through prescribing a definite test or measure of the property rights involved. That measure is the "value", or economic equivalent of the property. The Government would emasculate this rule by an interpretation which it is inconceivable that the Court in *Smyth* v. *Ames* would have laid down, because it leaves solely to the discretion of the Commission what protection shall be given to the utilities. No judicial test is suggested by the Government brief. It urges that in this particular case the determination of a so-called "value," based professedly on original cost, should be approved by the Court, although *Smyth* v. *Ames* required that the *value* of the property be determined, and thereby overruled the arguments of both the railroads and the state favorable to the adoption of the original cost and reproduction costs, respectively. The Government thus proceeds without any definite conception of value, and as a consequence is unable to suggest any criterion by which this Court shall determine whether constitutional rights have been infringed. It declares therefor: "This discretion (*i. e.*, the Commission's discretion in determining the sum upon which the earnings shall be calculated) will not be reviewed by the courts and the order made by the Commission in the exercise of such discretion, is not invalid as made without due process" (Title of Chapter V, p. 72). Thus constitutional rights are to rest in the discretion of a legislative agency which has proceeded in plain disregard of the statute. The courts are to abdicate their judicial function.

14. Congress did not impose insuperable burdens on the Commission in requiring it to obey the law of the land.

Throughout the brief of the Commission there recurs in different forms the statement that the method of valuation employed by the Commission "is the *only* method susceptible of practical application if the recapture provisions of the Transportation Act are to be administratively workable" (Brief, p. 54. See also pp. 33, 93, 120-122). Bluntly stated, the argument is that unless this court approves the method of valuation here applied to the O'Fallon and authorizes the Commission to apply it to every other railroad subject to recapture, "the key provision" of the rate making rule cannot possibly be administered. In *United States ex rel. Kansas City Southern v. Interstate Commerce Commission*, 252 U. S. 178, the Commission made the plea that it could not by any process of rational determination perform a valuation duty imposed up it by the statute. But the Court held that it must obey the law.

The Commission exaggerates the difficulties involved in a compliance with the law. It objects to the necessity of revising the value of all the railroads that may be subject to recapture (p. 33) and to the requirement of annual computations of the excessive earnings of all the railroads (p. 93). No such requirement exists. This is indicated by the report in this very case, where the Commission determined that there was no income of the Manufacturers' subject to recapture, without making any valuation whatsoever (R., 78, 83). This necessarily would be true of many railroads, particularly when the earnings of the

roads as a whole average only four or five per cent. on a valuation based on a pre-war basis. Furthermore, in the eight years which have elapsed since the close of 1920, the Commission has instituted only 50 recapture proceedings, in 32 of which the hearings have been concluded (42nd Annual Report, 6). These are indications that the Commission's discussion of impracticability is exaggerative. Apparently, even under the Commission's valuation theories, which derive a low result by basing the determinations on a pre-war price level, there are relatively few roads subject to recapture, and the burden of those cases cannot be heavy. Similarly, in the course of the eight years in which the Transportation Act has been the law, the Commission has never made a rate adjustment for the country on a basis of the valuation reflecting full use of the data derived under Section 19a. The basis of regulation, as the Report discloses, has been the finding originally made in *Ex parte* 74, in 1920. Consequently, it cannot be said that the determinations of value for the purpose of general rate adjustment are a heavy burden on the Commission.

The value rule of *Smyth* v. *Ames* requires consideration and protection of the railroads' property rights. Of course, if the Commission may regulate the railroads without regard to such rights, its burden will be lighter. But even if its proposal be adopted, and the test of value be that sum which, considering the nation as a whole, secures a proper inflow of capital to the railroad industry, there will be great controversial issues involved. It is simpler to determine the actual value of a 9-mile railroad than to marshal and weigh all the variety of issues pertaining to the adequacy of the rate schedules to sustain the national railroad system.

The Commission in this particular case has attempted to approximate the prudent investment in this property and for that purpose uses a pre-war reproduction appraisal which considers such highly controversial elements as going value and depreciation, among others. Such a method is not less burdensome than a determination of the actual value of the property under a proper interpretation of *Smyth* v. *Ames*. Every carrier should have the right to contest the accuracy of the pre-war reproduction estimate, the propriety of the conclusions regarding going value and depreciation, and the accuracy of the relationship between the result thus derived and the actual or probable prudent investment. Of such rights the carriers cannot rightly be deprived. The proposal of the Commission in effect is that it be relieved of the burden of rightly adjudicating these rights, through the declaration of this Court that the rights are not to have judicial protection. The consequences of the affirmance of the rules of law proposed by the Commission and the Conference are more seriously destructive of the rights of the railroads than may be apparent without careful consideration. Under this theory the "value" fixed by the Commission for all railroad property built before the war, is reduced to the dead level of the assumed prudent investment therein, regardless of the differences in quality of the various railroad properties. All railroads are not alike. All investments do not produce property of equal value. But the Commission's theory reduces them all to the same common level. As a consequence great injustice is done to the better properties, of which the O'Fallon is an example. The value arising from its superior quality being disregarded, and

its earnings being subjected to recapture on the basis of the low investment cost, its owners are effectively deprived of the real value of the property.

The doctrine advanced by the Commission is applicable to phases of railroad regulation other than rate regulation and recapture. If it were true that the carriers do not have property rights which may be rationally valued, it would be true in all cases where, heretofore, the constitutional right arising from the protection of the value of their property has been invoked. For example, the Commission in its discretion would be free to regulate accounting practices even though they unjustly affect the value of a carrier's property, so long as the credit of the railroads yet remained on a plain sufficiently high that a proper inflow of capital to the industry occurred. There is under consideration in Congress legislation pertaining to the enforced consolidation of railroads. If the railroads have no rights in private property, as the Commission and the Conference suggest, any scheme of regulation requiring consolidation without regard for the value of the particular railroad, would be sustainable so long as the results might properly be said to lie within the range of the discretion of the Commission as to what is desirable, from standpoints of broad public policy.

SINGLE-SYSTEM TREATMENT[1]

(1) The finding of the Commission is subject to judicial review by this Court.

In the District Court, the Government contended (in its Answer, R., 114, and its Brief below (pp. 3-4; 11-17), that the finding of the Commission against single-system operation, was conclusive,—not subject to judicial review. Its answer contained a motion to strike from the petition Section (13) thereof (R., 10-18), which attacked the finding of the Commission on the question of single system operation. The Commission joined in this contention of the Government. The District Court overruled the motion "to strike" (R., 148-149), and the majority opinion (R., 132) held against the contention.

Although there was a joint cross-appeal by appellees (R., 161), it did not cover this adverse ruling, and this point is not in their assignments of error (R., 163-165), nor in their "points" (R., 656-657). The Government frankly admits (Brief, 21-22) that upon this state of the record, the correctness of this ruling below, "is not presented" on this appeal. The Commission seeks, nevertheless, to renew the contention (Com. Brief, 190-191).

Since the real party in interest (the Government) has conceded the point, it will not be discussed in this reply

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[1]Under this title, reply will be made to the contentions of both the Government (U. S. Brief 20-36) and the Commission (Com. Brief, 189-199).

brief. It was sufficiently explained, with citation of authorities, in our opening brief (p. 117).

The findings of the Commission and of the District Court that appellants' properties are not "operated as a single system," are therefore open for review on this appeal, and are discussed in the briefs of all the parties of record.

(2) The new contentions made by the Government, that the record contains "no conclusive evidence of common control," and that the carriers' brief admits "that there is no common control," are not supported by the record.

As the District Court said (R., 132):

> "The Commission found a common control and management but not a single system operation of the two carriers."

Neither the Government nor the Commission contended below, that there was not "common control and management." The case below was tried, argued and decided on the assumption that there was "common control and management." The disputed issue, in this part of the case, was solely whether or not the properties were "operated as a single system."

The contentions that there was "no conclusive evidence of common control, and that appellants' brief "admits" that "there is no common control," are sought to be predicated on the following testimony of A. E. Wright, Secretary and Assistant to the President, of both companies:

> "There is almost complete common ownership of these properties. The Adolphus Busch Estate owns more than a majority of the stock *of each*. Excepting sixty-five shares of the Manufacturers Railway Company's stock, and a few qualifying Director's shares, all of the stock of both companies is owned *by the Adolphus Busch Estate or by member of the Busch family* (R., 291-292).

Upon this testimony the Government argues (U. S. Brief, 22-23) that, admitting the facts, they constitute no evidence of common control because the list of stockholders of neither company is in evidence, and because

> "For all that appears, the Estate of Adolphus Busch through its executors or trustees might own the major part of all the stock of the Manufacturers and the individual members of the Busch family, who might or might not own shares in the Estate, the major part or all the stock of the O'Fallon. In other words the 'common' ownership of the stocks of the two companies may depend entirely upon 'common purpose' of a number of individuals, who, in the event of differences of opinion, might terminate the 'common control' in a moment. The statute contemplates more than this: it implies 'control' not 'concurrence.'"

This argument for the Government is obviously based on a mistaken conception of the above quoted evidence.

It will be noted that both the witness Wright and the Government's brief properly distinguish between "the Adolphus Busch Estate" (i. e. his executors or trustees),

and "members of the Busch family,"—as stockholders. But in so distinguishing, the witness testified that the "Estate owns more than a majority of the stock of each" of the two companies. He also testified (R., 438) that:

> "The stock of *both* Companies is *controlled very largely* by *the Estate* of Adolphus Busch and the minority holdings were distributed to the heirs of Mr. Adolphus Busch, his several children."

This being true, the above hypothetical situation suggested for the Government, viz., "that the Estate might own the major part of all the stock of the Manufacturers, while the individual members of the Busch family, who might or might not own shares in the Estate," might own "the major part or all of the stock of the O'Fallon,—at once appears to be *impossible*.

"Common ownership" (speaking substantially) and "common control," necessarily exist in the Estate,—the executors or trustees—of Adolphus Busch, because they own more than a majority of the stock of each of the two companies. The existence of the common control that the statute requires, here rests firmly upon the fact of common controlling ownership by the Estate, and does not at all rest on the mere concurrence in opinion of the individual members of the Busch family who also own some (a minority of the) shares of stock.

That the argument for the Government was based on a misconception of the above quoted testimony appears clearly on page 33 of the Brief.

After making a quotation from the majority opinion below that includes the following (italics ours):

> "There is little room for such difference, in so far as 'common control and management' is concerned, for *the evidence is clear* that the *Adolphus Busch Estate owns a large majority of the stock of both carriers* and that there is a common executive and office force which handles and controls the business of each (R., 133).

the Brief makes this comment (italics ours):

> "As we have shown above, the evidence was that *the majority stock* was owned by *the Busch Estate 'or* by *members of the Busch family'* (Rec., pp. 291-2)."
>
> *"The court did not analyze the testimony* as to the *stock ownership* as *we have done*."

Appellants respectfully submit that in this difference between the District Court and the Government, in their respective understandings of the testimony of the witness Wright, the District Court was clearly correct, and the Government is mistaken.

The undisputed testimony was that the "Adolphus Busch Estate owns *more than a majority stock* of *each*" and *"of both,"* of the appellant companies, (R., 291, 438). The control is not divided between the Busch Estate on the one hand and members of the Busch family on the other, as the Government seems to think, but is held by "a large majority" in single control by the Busch Estate. And from this fact, the conclusion of "common control" is necessary.

(3) Under subdivision "(B)," (U. S. Brief, 23-24) the Government contends that the issue of "single system operation" is almost entirely one of fact.

If this contention is to be taken literally, appellants respectfully dispute it. The issue involves as questions of law, the construction of the statutory expression "operated as a single system," and the correct application of such construction to the facts, all of which are undisputed. Consequently there are no "issues of fact." The facts being undisputed the issue necessarily turns on questions of law.

The cases cited on page 23 (U. S. Brief), support the proposition that the Commission's findings of fact upon matters that are peculiarly within its province, will not be judicially reviewed if they were based on evidence. But these cases are not in point here for two reasons, first, because appellants are attacking the finding of the Commission on this question of single system operation, partly on the ground that it is without supporting evidence, which brings it within the doctrine of the above cases, and second, because the instant case, on this issue, is not of the kind dealt with in the above decisions.

Here, appellant's contention was and is, that the statute granted them the substantive right to single system treatment, because they constituted within the meaning of the statute "a group of carriers under common control and management" and because they were "operated as a single system"; and that the Commission erroneously denied this statutory right, and did so without supporting evidence, contrary to the undisputed evidence and upon an erroneous interpretation of the statute.

Such a controversy is essentially different from the class of cases illustrated by the decisions above-mentioned.

The *Los Angeles Switching Case* (234 U. S. 294) cited for the United States (U. S. Brief, 24) illustrates the kind of matters of fact to which the above decisions apply, but is not at all in point in the instant case. It was decided in 1914, long before there was a Recapture Act, and did not involve a dispute as to whether the industrial sidings owned by a trunk line constituted a part of the trunk lines' or railroads' systems that performed the line haul; there could be no dispute that they were a part.

The order attacked was one in which the Commission had directed the carriers to desist from making a per car charge in addition to the rate, "for delivering and receiving carload freight to and from industries located upon spurs and side-tracks within their respective switching limits, * * * when such carload freight is moving in interstate commerce incidentally to a system line haul"; (234 U. S. at 302).

The basis of the attack was that the charge was unjust and discriminatory under the circumstances disclosed by the record before the Commission.

The Commission had held that it was, saying (234 U. S. 309):

> "The service here given is not additional to that for which the rate pays. If the shipper pays for team track delivery and does not receive it, but asks instead a side-track delivery which costs the carrier no more, he may not be compelled to pay an additional charge upon the assumption that he has received a terminal team-track service which has not been given. A carrier may not so construct its

> rates as to compel an extra charge for like service, and this, in our judgment, the defendants at Los Angeles have done."

It was this conclusion of the Commission that the court refused to review, unless it was unsupported by evidence. While the words "system line haul" were used in the opinion they obviously meant no more than the words "line haul" would have meant without the added word "system."

(4) Appellants respectfully dispute the contentions of the Government and of the Commission that a court review of the facts before the Commission will show that "the evidence is conclusive in favor of the findings of the Commission."

(a) THE PERCENTAGE OR VOLUME OF TRAFFIC "ORIGINATING ON THE O'FALLON" THAT "MOVES TO POINTS ON THE MANUFACTURERS," IS LARGE AND SUBSTANTIAL; IT IS NOT "VERY SMALL," AS APPELLEES CONTEND.

With a persistence that is strange in view of the clarity and emphasis with which their error was pointed out in appellants' brief (134-136), appellees still cling to their erroneous statements: that *"only a very small percentage* of the traffic originating in the O'Fallon moves to points on the Manufacturers" (Com. Brief, p. 192); that *"only a small percentage* of the O'Fallon's traffic" moves from the O'Fallon "to industries served by the Manufacturers," (U. S. Brief, 28); and that there is *"no regular through traffic"* (U. S. Brief, 28).

It is of great importance that the undisputed record evidence on this point be correctly understood, because the point was treated by both the Commission and the court below as controlling against the granting of single system treatment, and because appellants contend: that there *is* unity of transportation service as between these two carriers; that the O'Fallon performs a line haul service as to a substantial amount of coal, in "a steady movement" from points on the O'Fallon to points on the Manufacturers; and that this line-haul service of the O'Fallon is supplemented in St. Louis by the terminal and switching service of the Manufacturers, in like manner as the line haul service of all the coal carrying trunk lines, is supplemented by the terminal and switching service of the Terminal, or of the Manufacturers, or of such west side lines as perform terminal and switching service in St. Louis.

Therefore at the risk of some repetition, the undisputed record facts are here presented:

"The O'Fallon is engaged almost exclusively in the transportation of coal" (R., 295, 438). "At least 99% of the total traffic of the O'Fallon consists of coal. It all moves westbound" (R., 299).

This coal originates partly at "mines on the O'Fallon" (R., 374), and partly from mines (the "Prairie and St. Ellen" mines) located on the electric line (the "East St. Louis and Suburban") with which it connects near its eastern terminus, (R., 309).

"I am referring now to the O'Fallon. Our traffic is confined almost wholly to the cities of St. Louis and East St. Louis. We have a *very large trade* with many of the prominent industries there and with most of the large

retailers. All these industries had a very marked advance and stimulus in the years following 1914 up to 1921 or 1922, and as a result of the stimulus of these industries there was a local demand for the product, the coal of the Busch mines, which was transported with the product of other coal mines on the East St. Louis and Suburban into East St. Louis and St. Louis. *Practically our entire traffic consists of coal from the mines going to St. Louis and East St. Louis principally* • • • Our transportation from the mines to St. Louis and East St. Louis is *the delivery of coal from the mines to the industries*" (R. 433). Traffic goes "*very largely*" from one road to the other. "There is a *good deal* of the O'Fallon coal that comes to the Manufacturers Railway" (R., 443).

"We handle *a very large percentage of coal* on the *Manufacturers, a great deal of which* comes *from the O'Fallon*" (R., 297).

"There is existing *a steady movement of coal* from mines on the O'Fallon to industries on the Manufacturers" (R., 295).

As stated in appellants' brief (p. 135), no proof was found in the record showing the total amount of coal that moved during any or all of the recapture periods, from mines on the O'Fallon to consignees located on the Manufacturers. But since the preparation of the brief, our attention has been called to an exhibit introduced by the Commission (Field's Exhibit 37, R., 582), which shows certain facts that are of special interest in this connection. It shows as the total freight carried by the O'Fallon during each of the recapture years:

In 1920	1,827,549 tons
In 1921	1,184,914 tons
In 1922	1,037,179 tons
In 1923	1,675,519 tons
Total freight carried during said four years	5,725,161 tons.

The evidence above quoted shows that more than 99% of the freight carried was coal, all of which moved westward from the mines, destined chiefly to St. Louis and East St. Louis. Therefore deducting 1%, representing freight other than coal, i. e..... 57,252 tons, leaves as the total amount of coal transported during the four recapture years...5,667,909 tons, or an average per year, of 1,416,977 tons. Using the same figures the average total freight carried for 1922 and 1923 was 1,356,349 tons. Deducting the 1% representing freight other than coal, 13,563 tons, leaves as the average coal transported in the years 1922 and 1923, 1,342,786 tons.

Wright's Exhibit 82 (R., 590) shows that during the period of approximately one year, from August, 1922, to July, 1923, the total tons of coal transported by the O'Fallon for the Suburban and Electric Line, were 404,125. Deducting this from the above average for the years 1922 and 1923, shows that the O'Fallon transported *from mines on its own line* an average of 938,661 tons per year, which is 69.9% of the total average of coal transported by it. It thus appears that substantially 70% of the total coal

transported by the O'Fallon originated on its own line. Moreover, it is entirely possible that some of the more than three hundred industries served by the Manufacturers, may have been consignees of "Prairie" and "St. Ellen" coal, so that some of the tonnage transported by the O'Fallon for the Suburban line may have been handled by the Manufacturers also.

In addition, there is the further testimony of Mr. Wright (R., 299-300) that "at times, particularly during the period of the War, the O'Fallon transported a little over 20 per cent. of all the coal that came into the St. Louis terminals, and particularly during that period we were very active in handling trains from the O'Fallon to the Manufacturers Railway."

Appellants respectfully submit that the above uncontroverted facts afford no basis whatever tending to support the finding of the Commission and of the court below, that "Only a very small percentage of the traffic originating on the O'Fallon moves to points on the Manufacturers."

The only reasonable possible conclusion from this evidence, is that during the recapture periods there was a very substantial quantity of coal originating on the O'Fallon line, that was transported in "a steady movement" from the O'Fallon to industries on the Manufacturers, and that in respect of this substantial and steady flow of traffic, the line haul service of the O'Fallon was supplemented by the terminal and switching service of the Manufacturers. Together, these two carriers provided "a unit of transportation service."

The fact that in the reverse movement, from the Manufacturers eastward to points on the O'Fallon, "there is no

steady or substantial movement of traffic" (R., 374), is adequately explained by the fact that (R., 374):

> "There naturally would not be. The vast majority of industries on the Manufacturers are manufacturing plants. Of course their commodities are moving out. The O'Fallon is nothing more or less than a producer of raw material. There are mines on the O'Fallon and those mines do consume supplies of various kinds. So there is some movement. That movement consists of mine props, small mine ties, oil and hay, feed, straw for the mine mules, commodities used in the operation of mines" (R., 374).

The transportation relation between these two carriers is, therefore, similar in nature to that of every other coal road in the United States that begins at coal mines and ends in the terminal zone of a coal market, where the line haul transportation service of the coal road is supplemented by the terminal and switching service of some terminal carrier or carriers on whose tracks are located the industries to which the coal is destined.

The fact that the O'Fallon is a short road, and that the mines at which its freight originates are located close to the market, so that the road enjoys an unusual advantage through its location, cannot change the essential nature of the transportation relations between the O'Fallon and the Manufacturers. As has been shown, their service as to a substantial and steady movement of coal from the mines to the industries, is that of a line haul transportation service supplemented by a terminal and switching service. There is no evidence *contra*.

In this connection it is deemed expedient to correct the statement in the brief for the Commission (pp. 196-197), that the above finding of the Commission that

> "Only a very small percentage of the traffic originating on the O'Fallon moves to points on the Manufacturers,"—

"was not specifically challenged in the District Court," except (a) by the general allegations of the petition (R., 10, 29), and (b) by the statements in appellants' brief below (p. 78), that

> "There is a steady movement of coal from mines on the O'Fallon to industries on the Manufacturers (Narr. St., Vol. 1, p. 13).
>
> "The Manufacturers handles a very large percentage of coal, a great deal of which comes from the O'Fallon (Narr. St., Vol. 1, p. 16)."

In making the foregoing statement the Commission overlooked the additional statement (appellant's brief below, p. 79) that

> "In its service of more than 300 industries in" (the Manufacturers) "provides delivery points on its rails and terminal and switching service by which large quantities of coal that originates on the O'Fallon reach the consignees, both consumers and dealers."

The Commission also completely overlooked the Reply Brief for Appellants in the District Court (pp. 77-78) in which said finding was expressly challenged as "clearly erroneous and misleading," and in which it was said (p. 78):

> "*The undisputed evidence before the Commission showed* that practically the entire traffic of the O'Fallon consists in coal transported from the mines, going to St. Louis and East St. Louis principally. There is very large business with many of the prominent industries and with most of the large retailers in those cities (Narr. St., Vol. II, p. 64). At least 99 per cent of its traffic consists of coal, all of which moves westbound (Narr. St., Vol. I, p. 20). At times, particularly during the war, the O'Fallon transported more than 20 per cent of all the coal that entered the St. Louis terminals (Narr. St., Vol. I, p. 20). *There is a steady movement of coal from mines on the O'Fallon to industries on the Manufacturers* (Narr. St., Vol. I, p. 13). *The Manufacturers handles a very large percentage of coal, a great deal of which comes from the O'Fallon* (Narr. St., Vol. I, p. 16)."

(b) THE CONTENTION FOR THE GOVERNMENT ABOUT THE EFFECT OF THE DECREE IN THE TERMINAL CASE (224 U. S. 383) FALLS FAR SHORT OF THE COURT'S OWN EXPLANATION OF THE DECREE.

Appellees attempt to avoid the effect of the decree as showing that the appellants have a legal right,—established by the decree,—to use *as their own* the intervening rails and bridges of the Terminal, by saying that:

> "It is not contended that either the O'Fallon or the Manufacturers *applied for admission to joint ownership* and control of the Terminal properties pursuant to the above mentioned decree; neither company *has a contract* covering the privileges of its lines over the rails of the Terminal;" (U. S. Brief, 30-31. Italics ours.)

This is an insufficient answer to appellants' contention. The decree shows that no such "application" was necessary. The appellants, as carriers that did not elect to become joint owners with the proprietary lines of the Terminal, were, by the decree, given the right to use the Terminal's facilities (Appellants' Brief, 149-150).

Nor does it suffice to say (U. S. Brief, 31), that appellants had "no contract" for the use of such facilities. No contract was necessary. Appellants acquired such right *by virtue of the decree*, a source and form of right far greater and more enduring than any contract would have been.

It is contended further (U. S. Brief, 31; italics ours) that:

> "Even were the contention of the appellants sound on this point, it would still fall short of establishing that the two railways are operated 'as a single System.' At the very most, it shows *no more than the possibility* that the companies might use the Terminal tracks to bind themselves into a single System. But a *mere possibility* is irrelevant, when it appears so clearly that *in fact* these companies did not avail themselves of it."

The undisputed evidence before the Commission showed far more than a "possibility that the companies *might* use the Terminal tracks to bind themselves into a single System." It showed *such use as an existing fact*, and *a uniform practice* to so use, ever since 1912, after the Terminal case was decided (Appellants' brief, 126-127). It showed that appellants in common with all other East Side lines had constantly and uniformly used these cross-

river facilities of the Terminal. It showed that such use by the appellants was availed of in each of two ways, permissible under the decree: (1) by using their own locomotives and train crews, and (2) by having the Terminal, as their "agent or servant," perform the intermediate service.

The facts are correctly stated, with the record references, in appellants' brief (pp. 126-7), and will not be repeated here. The statement that there was not "a regular movement of through traffic over the Terminal tracks" (U. S. Brief, 31), is incorrect because the record shows that all of the coal transported by the O'Fallon and destined to cross-river points *must* and *does* pass over the Terminal tracks,—there are no other cross-river facilities (Appellants' Brief, 126-127).

That there was "a steady movement" of O'Fallon coal through to industries on the O'Fallon, has been shown above.

The statements (U. S. Brief, 31) that "in 1922 and 1923 there was hardly any use of the Terminal facilities," had reference to use by appellants' own locomotives and crews. It did not refer to the use of the Terminal's facilities by the alternative method permitted by the decree,—causing the Terminal, as the "agent or servant" of appellants, to perform the intermediate service.

It is therefore wholly erroneous to contend (U. S. Brief, p. 31) that: "Any argument based on physical connection through use of the Terminal facilities, has very slender basis in fact."

As shown above, the basis is not only very substantial, it is complete. It applies to *all* of the coal that moves

from the O'Fallon westward, across the river, to consignees on the Manufacturers, or elsewhere.

The existence (noted in U. S. Brief, p. 27) of an independent rate established between the appellant carriers, is of no significance on the question of single system operation. Nor is the fact important that appellants make separate annual reports to the Commission in which there is "no indication of operation as a single system." Being separate corporations, the statute and the rules of the Commission require separate annual reports, and the forms prescribed for such reports do not call for any indication as to single system operation.

(5) The contention for the Government (Brief, p. 35), that by using the words "single system," Congress "must have intended that railroads, to come within the meaning of this exception, must constitute a single system," is respectfully disputed.

The obvious reply is, that Congress did *not* say so. It said quite otherwise. It said that in addition to being commonly "controlled" and "managed," they must be "*operated* as a single system" even though the various parts are separately "owned" and make separate "accounting returns."

The use of the word "operated" may not be disregarded or deleted as the Government thus seeks to do. Unless the interpretation contended for by appellants (Brief, 116) is correct, the words "operated as a single system," would become superfluous and meaningless. Certainly, if two railroads are under common control and management and are operated together precisely the same as they

would be if owned by the same company, it is difficult to see how there could be a better demonstration that they are operated as a single system.

The suggestion that these two railroads are not operated as "a single system" because the work of train and track men is localized, is without merit. Services of such employees are localized on separate divisions of the same railroad. Pro-rating of their time when temporarily working for the other company is without significance. To make proper accounting reports as separate corporations, as required by the Act, would compel such pro-rating. Moreover, a proper division of accounting would require such pro-rating even if both railroads were owned by the same corporation.

(6) The effort of the Commission to preclude discussion of the merits on single system operation, by relying on a letter of Auditor Marsh, is without merit.

The Commission's Brief (p. 192) renews its effort in the court below, to disprove single system operation, by quoting from a letter of Mr. Marsh, the auditor and treasurer of both of the appellant companies, the following, which appears of record (R., 626):

> "I wish to say for your information, that the St. Louis and O'Fallon Railway and the Manufacturers Railway are owned by the same people and are operated separately" (R., 626).

Mr. Marsh was also Treasurer, but this letter was written by him as "Auditor" of the O'Fallon. While the

letter contains the above quoted statement, it also contains the following paragraph not quoted in the Commission's brief:

> "The owners of these two properties feel that the law should be applied to both properties and if there are excess earnings on the St. Louis and O'Fallon Railway, that it should be applied towards a return on the amount invested in the Manufacturers Railway, as earnings from divisions allowed by the trunk lines barely pay operating expenses and taxes, but leave nothing to apply on the value of property.
>
> "The owners of the Manufacturers Railway have received no returns for more than ten years on the value of the property."

Apparently the Commission seeks to use the first above quotation as an admission against interest, precluding the O'Fallon from a consideration on the merits, of the question of single system operation.

Appellants respectfully submit that this effort should prove unavailing because:

> (*a*) Statements or admissions upon a question of mixed law and fact are not admissable in evidence, because "a party should not be affected by statements which may be attributed to a misapprehension of his legal right"; (22 *C. J.* 298).
>
> (*b*) It is clearly not within the scope of the duties of either the treasurer or auditor of a railroad to *operate* the railroad or to pass on questions of law relating to its operation. Therefore, even

if the Marsh letter as a whole were open to the interpretation sought by the Commission to be given to it,—that Mr. Marsh admitted that there was no single system operation within the meaning of Section 15(a), his conclusion or opinion on this mixed question of law and fact would not have been admissible or binding.

(c) In the light of the surrounding circumstances, it cannot be contended with merit that the letter constituted an admission that within the meaning of Section 15(a) these two railways were operated separately.

Mr. Marsh was auditor and treasurer, presumably with the customary powers and duties of those positions. From his point of view, in respect of the duties performed by him, and of the books and records kept by him, his statement was correct that the O'Fallon and Manufacturers were operated separately. They were separate corporations and both the statute and the accounting rules of the Commission required them to be treated separately as to all matters within the scope of Mr. Marsh's authority. His letter was written October 3, 1922, more than a year and a half before the Commission had started this recapture proceeding, and still longer before any controversy had arisen in the proceeding over the question what would constitute single system operation.

Certainly the letter in its entirety, adequately informed the Commission that the owners of the appellant railways *thought they were entitled to single system treatment.*

(7) The fact that the purpose for which Adolphus Busch acquired the O'Fallon, has not yet been fully accomplished, affords no basis for the contention that until it is accomplished, there is no single system operation.

The facts are stated in appellants' brief (121-2; 133-134).

The briefs for the Government (pp. 28-29), and for the Commission (p. 193), give the impression that appellants are basing their contention that there was single system operation during each of the recapture periods, partly upon *the purpose* for which Adolphus Busch, then (in 1913) owning a large control of the Manufacturers, acquired the O'Fallon.

Appellants make no such contention. The "purpose for which the O'Fallon was acquired,"—came into this case through the fact that in its Report (R., 45) the Commission held that the "unity of purpose" which it interpreted the Act as requiring, did not exist here, partly because "the purpose for which the O'Fallon was acquired is not clear on the record."

Appellants (Brief, 133-134) contend that the Commission erred in its above statement of fact that the purpose was not clear on the record; and they also make plain their further contention, that although said purpose (of ultimately making a physical connection between the two properties) has not yet been accomplished, the fact is immaterial here, because during the recapture periods appellants had the right to use, and did use, as their own, the intervening facilities of the Terminal.

(8) The Manufacturers was financially dependent on the "common pocket book" of the Busch Estate into which passed the substantial dividends of the O'Fallon.

The Commission's Brief (p. 194) argues:

> "It is the Busch pocket-book that is common, and it may be safely assumed that so long as the sixty-five shares of capital stock do not belong to that pocket-book there will be no use of the revenues of the O'Fallon, for the benefit of the stockholders of the Manufacturers."

This argument proceeds on the erroneous assumption, that even if the Busch Estate owned *all* of the stock of *both* companies, it would be legally possible for the O'Fallon Company to use its revenues for the benefit of the Manufacturers, except through dividend payments to the common owner, who would then be at liberty to lend needed money to the Manufacturers.

This subject is discussed at pages 136-139 of appellants' brief. In addition to the record facts there stated or referred to, attention is respectfully invited to the following additional facts:

The letter of Auditor Marsh, October 2, 1922 (R., 626), shows that the earnings of the Manufacturers "from divisions allowed by the trunk lines *barely pay operating expenses and taxes*, but *leave nothing to apply on the value of property*," and that its owners had received no dividends for more than ten years.

Fletcher's Exhibits, 9-13, referred to at R., 498, and on file with the Clerk as part of the record before the Commission, show $1,500,000 (presumably 15,000 shares)

as the capital stock of the Manufacturers. Of this number, the sixty-five "outside" shares constitute a trifling proportion.

Exhibits 23-26 of McEntee (another witness for the Commission), also a part of said record before the Commission, show that for the period from July 1, 1917, to December 31, 1923, the Manufacturers reported expenditures for additions and betterments to, and retirements of, its property, $215,608.74, which amount was "adjusted" by the Commission to $121,123.62.

The evidence offered by the Commission, which showed outstanding bonds of the O'Fallon, did not disclose any bond issue or other public borrowing by the Manufacturers.

Therefore it is a fair inference of fact from the record that the Manufacturers, which was earning barely enough to pay its operating expenses and taxes, and was paying no dividends, had to borrow money with which to make such extensive improvements as the map shows and the above expenditures indicate.

It is also a fair inference of fact that the Manufacturers must have received its needed financial support from the Busch Estate as the common owner who had benefited and was benefiting by the substantial dividends received from the O'Fallon.

Appellants respectfully renew their contention: that under the law and the undisputed evidence, they were entitled to single system treatment; and that the findings, rulings, decree and order *contra*, were unsupported by the evidence, contrary to the undisputed evidence and contrary to the statute when properly construed.

INTEREST.

(1) The power given to the Commission by paragraph (9) of Section 15a, "to prescribe rules and regulations for the determination and recovery of the excess income payable to it," could not possibly include power to collect interest when no interest is required by the Act.

Both the Government (Brief, 111-112), and the Commission (Brief, 200-201), contend that the granted power "to prescribe rules and regulations," etc., included power to prescribe by "rule," that interest at six per centum per annum would be required; and apparently they rest the claim for interest on this contention.

Appellants respectfully submit, that the above statutory grant of power to make "rules and regulations," was *expressly limited* to the subjects of "determining" and "recovering," the recapturable amounts. The "rules and regulations" thus contemplated, were obviously intended to be merely administrative in scope, to prescribe the method and procedure by which to "determine" and "recover," the recapturable amounts. Neither subject, could, by even remote inference, be held to give the Commission power to decide whether or not the recapturable amounts should bear interest. This was a substantive question, for Congress, not the Commission, to determine. The charging of interest would add materially to the liability of the carriers, and since Congress failed to provide for interest, it seems clear that the Commission could not validly, by a mere administrative "rule," enlarge the statutory liability for recapture that Congress had created.

(2) Reply to further contentions concerning interest.

As to the further contentions of the Government in respect of interest (Brief, 112-114), appellants respectfully submit that before any adequate conclusion concerning interest can be reached, it is necessary to consider the peculiar legal nature of the anomalous relations between the O'Fallon and the Government in respect of amounts claimed to be recapturable.

It will not suffice to assume that the carrier is a "delinquent trustee," and to decide the question of interest on that assumption.

The trusteeship created by this statute and by it imposed *in invitum* upon the carrier, is unique, apparently unlike any common law or statutory trusteeship known to jurisprudence. Under the statute as construed in the *Dayton-Goose Creek* case (263 U. S. 456), the O'Fallon throughout each recapture period, received certain "railway operating income," some of which may, or may not, have been trust funds when received. The carrier did not know and could not ascertain during such year, how much, if any, of such income, constituted trust funds; therefore the amount could not be set aside or tagged for the beneficiary. Even at the end of the year, after its books had been closed, the carrier was still kept (by the statute) in ignorance as to the amount, if any, that was thus received "in trust." Certainly the carrier was not yet "a delinquent trustee."

The whole question of liability, and the amount thereof, if any, could not then have been learned by the carrier, not even from the Commission. The carrier could not learn what the Commission might thereafter claim, until

the Commission had gone through the process, long (in this case it was more than six years after the close of the first recapture period, 1920) and laborious, of auditing the carrier's books and accounts, of determining the amount (thought by the Commission to be correct), of gross operating income, of deciding what deductions taken by the carrier should be admitted, and then of figuring the "net railway operating income." In the meantime, the carrier was *waiting on the Government* (the Commission) to act by completing its duty under the statute.

But the task of the Commission was not yet completed, and neither the Commission nor the carrier could yet say how much, if any, trust money was received by the carrier.

Certainly the carrier was not yet "a delinquent trustee," although the above work of the Commission may have extended (as it did in this *O'Fallon* case) far beyond the four months' payment periods fixed by the statute. The Commission had still to perform the difficult, laborious and highly controversial task of valuing the property used by the carrier in the service of transportation, during said recapture year. This task it must perform in compliance with the directions of the statute, taking into account all of the factors that "the law of the land" required. When this had been done and the recapturable amounts computed, but not until then, could the Commission know what amounts, if any, it would claim for the Government, as recapturable.

Certainly the carrier was not yet "a delinquent trustee." It was still waiting, and compelled by the statute to wait, on the Commission. The carrier might or might

not hold money in trust, depending upon the correctness of the Commission's disputable conclusions as a result of its audit of the accounts, and as the result of its disputable valuation and the consequent computation of the amount claimed by the Commission to be recapturable.

There is no analogy thus far, to the case of an accounting common law trustee who has within his own control, the information from which he can determine for himself what part of his receipts were trust funds.

But the picture is not yet complete.

The statute contains no provision that the conclusion of the Commission as to the amount recapturable, shall be treated as *prima facie* correct.

So far as the Act is concerned, the carrier had, and has, a clear right to dispute in good faith (as the O'Fallon does), the existence of any liability, the correctness of the amount claimed, the legality of the valuation and other methods pursued, the correctness of the estimates, the interpretation of the Act, etc., and the carrier does not become a delinquent trustee by so doing.

Thus far, the Commission alone knew whether it would contend that the O'Fallon was subject to recapture at all, and if subject, what amount the Commission would claim. The carrier was kept in ignorance of these facts until the Commission had formulated its claim and announced the result.

On March 31, 1927, for the first time, the O'Fallon learned that a liability was claimed and the amount, based upon a claim then stale in respect of time,—that in 1920, 1921, 1922 and 1923 it had received trust funds for which an accounting and payment were demanded.

Up to this time, the carrier was clearly not "a delinquent trustee."

Having received the Report, and the Order, the carrier found itself confronted by a demand that it disputed in its entirety. This disputed claim had resulted, not through a liquidation by the judgment of any tribunal having judicial powers, but through the self-informing inquisition of the Commission, which was *the adversary claimant*.

Since interest in equity, when (as in the instant case) its recovery is not a matter of right, will be allowed or withheld according as all the circumstances of the case indicate will be equitable and just,—appellants respectively contend that the allowance under the above circumstances, of interest as claimed by the Commission or as allowed by the District Court, would be highly inequitable and unjust.

It is hostile to every conception of equity, that a disputed claim for an accounting and payment of trust funds, may be liquidated for the purpose of interest, by permitting *the claimant*, to also act *as judge*. It is hostile to every conception of justice, that interest may be allowed during long periods of time while the claimant is itself responsible for the delay in formulating its claim, which the statute requires to be first formulated by it before the carrier trustee can know whether, and for what, a claim may be made.

In support of the contention that a conclusive liquidation by a judicial tribunal is a condition precedent to the accrual of interest, appellants again refer to the decision in *Southern Pacific R. R. Co.* v. *United States*, 228 U. S. 618. In that case the questions at issue were (p. 629)

the liability of the railroads for interest and the date from which interest accrued, under a construction of certain Land Grant Adjustment Acts by which the railroad companies were required to account for the proceeds of lands erroneously patented to them and sold by them to *bona fide* settlers.

The Acts in question did not provide for any recovery of interest on amounts for which the railroad companies were required to account, and the Court held that there was no such liability for interest until the amounts for which the companies were liable to account had been conclusively liquidated, and that such interest should run only from the date of the commencement of the suit brought by the Government to recover.

The Court dealt with the question of liability on an admission by the Government (p. 630):

> "That the right to recover interest here asserted depends not upon the express liability imposed by the adjustment acts but upon general principles of law as applied to the facts of the case. Primarily the argument causes the liability for interest to depend upon the fact that *the railroad company received from those to whom it had sold the lands, the price thereof, of which moneys it has since had the possession, and therefore it should be condemned to pay interest* from the time the money was received" (italics ours).

It was contended (p. 631), that even though the purpose of the Adjustment Acts was simply to provide for the settlement of a situation which had arisen by common mistake,—the Government to receive for such lands merely

the minimum statutory price,—interest should, nevertheless, be allowed upon principles of equity because (p. 631) "of the definite nature and liquidated character of the obligation of the railroad to pay as manifested by the terms of the acts"; and "as the result of the legal proceedings taken by the United States to enforce liability under the adjustment acts and the course of judicial decision thereon." It was contended that interest should run from the date when the railroad companies came under an equitable obligation to account to the United States. In denying this contention, the Court said (p. 631):

> "Indeed, both the adjustment acts, as we have already pointed out, were long since treated by this court *as contemplating action by the Government to ascertain and fix the liability* which arose from their enactment" (italics ours).

After calling attention (p. 632) to the fact that "*the very foundation of the liability*" had "been in litigation *by action of the Government*," the Court said (p. 632):

> "There is no reason for holding that *until that controversy was determined the pecuniary liability of the railroad company was so liquidated as to justify the awarding of interest*. The question, therefore, is limited to determining whether the effect of the decree in the case decided in 1902, was to so fix the liability as to justify the awarding of interest from that date" (italics ours).

The Court held that it was not, saying (p. 632):

> "While the decree of 1902 determined who were *bona fide* purchasers, contrary to the contention of the Government, it did not pretend to fix the re-

> sulting pecuniary liability or embrace affirmative language conclusively protecting against the enlarged claim which the Government made in the suit. *Under the circumstances*, we think *it cannot be said* that *such a conclusive liquidation* arose or was deemed by the Government to have arisen *as to justify the awarding of interest*" (italics ours).

Also (at p. 633):

> "Looking comprehensively at the whole situation, * * * we think it is just to say that *the liability for interest* upon the statutory price *arose at the date of the commencement of the suit* and *no sooner;* and, therefore, that error was committed both in the trial court and in the Circuit Court of Appeals for not confining the commencement of the running of interest to that date" (italics ours).

The above case, like the instant one, involved an anomalous trusteeship imposed upon the railroad company by statute, the effect of which was to render the railroad liable to account for certain money received in trust for the Government.

The Government itself undertook, and long delayed, the determination, through prior litigation, of the questions of liability and amounts.

While there are points of difference between the above case and the instant case, they are substantially alike in the essential points, that under the circumstances in each case, a prior judgment of "conclusive liquidation," is necessary in equity to justify the awarding of interest.

THE RECAPTURE AND RATE MAKING PROVISIONS OF SECTION 19a ARE INTERDEPENDENT.

The United States (Brief, 107-110) and the Commission (Brief, 201-203) assert in effect that the trust of Section 15a became effective on March 1, 1920, merely because the Act as a whole then took effect. They assert that the Commission is only directed to fix rates which it may reasonably expect to produce a fair return, and that that it is immaterial whether the prescribed return actually materialized.

Both overlook the plain provision that the only income subject to recapture is that arising "under this section." As the Commission points out (Brief, 203) the rates in effect at the time of the passage of the Transportation Act were continued in effect by an express provision of that Act until changed by statutory or federal authority. *Those* rates would not produce any income which would be said to accrue under Section 15a. Certainly there was no such income until August 26, 1920, when there took effect the increase authorized in *Increased Rates 1920*, 58 I. C. C. 220.

The arguments based on the words "as nearly as may be" are defeated by the facts. These facts are stated in our opening brief (pp. 160-167). We find it very difficult to harmonize the contention that the rates were so fixed as to provide "as nearly as may be" the statutory return with the fact that the Commission in *Revised Rates 1922* deliberately reduced rates which confessedly already fell short of the statutory standard "by a considerable mar-

gin." The argument is that the words "as nearly as may be" are to be so broadly interpreted, that any rate increase will be regarded as a compliance therewith, which, even though slight, was "as nearly" the increase prescribed as the Commission regarded it desirable, in its discretion, to make, the Commission being vested with wide discretionary powers.

Such an interpretation is obviously erroneous. The language of the Act is directive and mandatory. It is not permissive, nor is it a mere declaration of a general legislative policy. The statute clearly orders that the Commission *shall* establish rates producing a return as nearly as may be to a fair return,—that is, which shall *approximate* the determined percentage of fair return, minor variations from that percentage being permitted by the language in question. The question resolves itself primarily into a question of Congressional intent. All the conditions surrounding the inauguration of this new scheme of rate making are inconsistent with the idea that minor rate increases, made in the discretion of the Commission were intended. As the Act evidences, and as this court has recognized, Congress intended that there should be *adequate* returns. The purpose of Congress would be defeated and its intent frustrated were this language interpreted to permit the Commission not to fix adequate rates. This Act inaugurated a new regulatory scheme, whereby adequate rates were to be made for the roads as a group on the prescribed basis. The theory is not that the Commission shall make reasonable rates with the general policy of permitting a fair return to the carriers, if the Commission finds it desirable. The fair re-

turn was intended to be precisely prescribed, "as nearly as may be" permitting minor variations from exact compliance, but not permitting a wide departure, as the result of which there might be no actual compliance with the Act. As is demonstrated in this case without contradiction whatever, the Commission never actually complied with the Act. In fact, it reduced rates in 1922 at a time when the earnings obviously were not those which Congress clearly intended the rates to create.

THE COURT ERRONEOUSLY DECIDED THAT ISSUES OF CONFISCATION WERE NOT PRESENTED IN THE CASE.

In our opening brief we contested the validity of the conclusion of the court below that there was not involved in this case an issue of confiscation. The argument is in two parts: (1) that the lower court erroneously included as a part of the carrier's income the amount required for the reserve fund, and therefore concluded that the moneys retained by the carrier were a fair return on the claimed value; and (2) that the lower court erroneously concluded that the requirement itself that the carrier pay more than the statute authorized constituted a confiscation. These issues are discussed in the briefs of the Commission and the Government. Little need be added to the discussion in our opening brief.

The Commission asserts that the amount retained by the carrier in the reserve fund is to be considered its free income. The reasons demonstrating the contrary conclusion are stated in our opening brief (Chapter p 33, *et seq.*). These moneys are ordered placed in a reserve fund in accordance with paragraph 6 of 15 a. (Opening Brief, p. 186). The regulation is not therefore a mere accounting regulation; it requires the actual maintaining of this fund and restricts its use. Consequently *Kansas City Southern Railway* v. *United States*, 231 U. S. 423, relied on by the Commission is not actually in point. That case involved an accounting regulation application to all the railroads, made by the Commission pursuant to its authority to prescribe the methods by which the

carrier shall keep accounts. This regulation was justified on the ground that "the accounting regulations do not seek to control railroad companies in the exercise of their discretion respecting what shall be done and how it shall be done, but only to systematize their accounts with respect to whatever is done" (450). It was held that the order was "no direct interference with the internal affairs of the corporation" (441). The case, contrary to the impression given by certain fragments of dicta quoted in the Commission's brief, is not a case where a direct confiscation issue was presented, based on the claim that as the result of the accounting classification it was not permitted a fair return on the value of the carrier's property. The claim of confiscation was merely that there was interference with the right of the carrier to declare dividends. There was no issue as to the value of the property and the carrier's return thereon. The case therefore is not in point.

THE APPELLANT RAILROADS WERE ENTITLED TO THE INDEPENDENT JUDGMENT OF THE COURT ON THE QUESTION OF VALUE, BECAUSE THE CASE INVOLVED AN ISSUE OF CONFISCATION AND WERE ENTITLED TO A TRIAL *DE NOVO* BEFORE THE COURT.

These issues are discussed on pages 48 and 175 of our opening brief. Since the bill tendered the issue of confiscation, the appellants were entitled to have the independent judgment of the court on the question of value and, consequently, were entitled to have such a hearing as would permit the development of the facts bearing upon the issue of confiscation. The right to introduce evidence in court arises from the fact that the issue there is a confiscation issue. The issue before the Commission was not. The authorities establishing the right to the independent judgment of the court are:

Ohio Valley Water Co. v. *Ben Avon Borough*, 253 U. S. 287;

Bluefield v. *Public Service Commission*, 262 U. S. 679;

Georgia Railway & Power Co. v. *Railroad Commission*, 262 U. S. 625, 629-30 (quoted, Commission's Brief, p. 179).

The leading authority with reference to the consequent and necessary right to a trial *de novo* is *Manufacturers' Railway Company* v. *Interstate Commerce Commission*, 246 U. S. 457, 489-90.

The right to the independent judgment of the court is predicated upon the existence of a confiscation issue, but even admitting the existence of this issue (which they do not), the briefs of the Commission (72-6, 204) and of the Government (36, 40) contest the right. The extremity of this position is sufficient to indicate its unsoundness. The position is consistent with the denial of the existence of any effective constitutional rights in the railroads. The decision of the Court in the *Manufacturers* case is a necessary corollary to the principle declared in the *Ben Avon* case. A reading of this decision will indicate its clear definition of the right to a trial *de novo*, which was allowed in that case, even though the carrier had not introduced testimony before the court.

Our theory with reference to the introduction of testimony is explained clearly on page 175, *et seq.* of our opening brief. The Court can exercise its independent judgment only on competent evidence and the record before the Commission is not substantive evidence in regard to all of the facts pertinent to the issues made by the pleading, but merely shows the evidence upon which the Commission acted. The evidence of most importance had largely to do with the current cost of reproduction and the permanency of the cost levels (R., 277-286). It should have been received.

CONCLUSION.

The appellants rely on the argument in our opening brief pertaining to the other issues discussed by the briefs of the Commission, the Government and the Conference, and with reference to which no additional argument is regarded as necessary.

Respectfully submitted,

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